INDEPENDENT PRICING AND REGULATORY TRIBUNAL

REVIEW OF MAXIMUM PRICES FOR THE VALUER GENERAL'S LAND VALUATION SERVICES TO COUNCILS

Tribunal Members

Dr Paul Paterson, Chairman
Mr Ed Willett and Ms Deborah Cope

Members of the Secretariat

Mr Matthew Edgerton, Mr John Madden, Mr Scott Chapman,
Ms Kumi Cuthbertson and Ms Regina Choi

At
The offices of IPART
Level 15, 2-24 Rawson Place, Sydney

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OPENING REMARKS

THE CHAIRMAN: Good morning, everyone, and welcome to this public hearing. I would like to begin by acknowledging that we are meeting on the Gadigal land of the Eora people and pay my respects to the traditional landowners past and present.

Today we are holding a public hearing on IPART's review into the maximum prices the Valuer General can charge for land valuation services provided to councils from 1 July 2019.

Let me start by introducing ourselves. First, I am Paul Paterson. I am the Chair of IPART - newly minted, day two - and this is my first public hearing as the Chair. With me I have my fellow tribunal members, Ed Willett and Deborah Cope, to assist in proceedings today.

Secondly, I would like to thank those people who put in written submissions in response to our issues paper on the Valuer General's pricing submission.

Public hearings are an important part of our consultation process for this review and other reviews. In addition to the views expressed in the written submissions, we will consider the views provided today in making our decision. So this is an important process and thanks for being here for it.

Following the public hearing, we will release a draft report for public comment. We will do that in early April. We will then leave about three weeks for further written submissions for consideration by the tribunal before we make our final decisions. Our initial report and determination will be released in May this year, which will contain the maximum prices to apply from 1 July 2019.

In general terms, our price review will be seeking to determine what are the Valuer General's efficient costs of providing land valuation services to councils from 1 July 2019, and how should these costs be recovered from councils through prices - so going to the issue of price structure.

Before we start today, I would like to outline the process for this public hearing. First, we will hear a presentation from the Valuer General on his proposal and then we will provide a short period for clarification. We will then have three discussion sessions.

The first session will focus on the level of the Valuer General's proposed efficient costs, including operating and capital expenditure. This will also cover the length of the determination period - so what lump of costs needs to be recovered?

The second session will cover the allocation of those costs to councils - so what proportion of those costs will be addressed by charges to councils? Importantly, after that second session, we will break for morning tea, but only briefly, and then the third session will cover the proposed prices - that is, the level and the structure of prices including the basis for charging individual councils.

So first, the costs to be recovered, how they are split between councils and, other entities, and then how the prices are structured and what level is proposed.

Assisting the tribunal today are members of the IPART secretariat. We have Hugo Harmstorf, the CEO of IPART, Matthew Edgerton, who heads up the area that is being considered, John Madden, Kumi Cuthbertson, Regina Choi and Scott Chapman. You will hear from some of these people as we proceed today.

I should advise you that today's proceeding will be recorded by our transcriber. Therefore, to assist the transcriber, it is asked that you please identify yourself when you speak and, where applicable, your organisation. We also ask that you speak loudly and clearly. This is in particular for people in the floor of the room, people speaking from the floor, could you speak up loudly and clearly so the transcriber can capture what you are saying.

A copy of the transcript will be made available on our website next week.

Jumping into proceedings, I would now like to ask the representatives of the Office of the Valuer General to state their names and positions for the record and then make their presentation.

VALUER GENERAL'S PROPOSAL

MR PARKER: My name is Michael Parker. I am the Acting Valuer General. I am supported here today by the executive director of Valuation Services Property NSW, Mr Dennis Szabo, and the director of financial planning and analysis for Property NSW, Mr Kevin Soo.

Over the next few minutes I would like to provide some background on:

The role of the Valuer General;
The role of Valuation Services;
Changes in the organisational structure since the last review;
Briefly talk about our performance over the current period before detailing our proposal for the referral period.

The Valuation of Land Act establishes the Valuer General as an independent statutory authority responsible for the overall management of the valuation system. The Valuer General regulates the system by setting the standards and policies as well as overseeing the quality of its outcomes. The New South Wales land valuations system supports the raising of $3.17 billion in land tax and $4.36 billion in rates.

The Valuer General formerly delegates all operational functions under the Valuation of Land Act to representatives within Valuation Services, Property NSW. These services are delegated through a service level agreement between the Valuer General and the deputy secretary of Property NSW, which is part of the Department of Finance, Services and Innovation.

Since the last review of the Valuer General's monopoly services by IPART in 2014, the organisational structure surrounding the valuation system has changed. Land and Property Information, which supported the Valuer General, was divided into five business areas. One of those business areas, Valuation Services, was moved to Property NSW. The Office of the Valuer General remained a separate unit within the Department of Finance and Services cluster. I will discuss later that changes in the structure led to increases in some of the costs for operating expenses.

The proposal we are presenting today is based on the following key objectives:

Full cost recovery of the Valuer General's efficient costs;
Fairness and equity;
Impact on councils;
Link to cost drivers; and
Simplicity.

As much of our proposal for the referral period is based on our past performance and the understanding of historic operational requirements, it is important to consider our performance over the current period.

On the income side, the total actual revenue we received has essentially been in line with target revenue, falling just $400,000 short over the whole determination period.

Since the last determination, there have been some key changes that have increased the cost of the valuation system. These include:

Implementation of the now postponed fire and emergency services levy;
Transitioning ICT platforms to GovConnect;
The separation of Valuation Services from LPI; and
The transfer of real property assets to Property NSW.

However, none of these costs have been passed on to local government but have been absorbed through additional state government funding of approximately $10.2 million in the current determination period.

In the current determination period, a number of important systems, processes and customer service enhancements have been implemented. Improvements were made in quality assurance; valuation information to the public; publication of the Valuer General's policies; introduction of preliminary reports for objections; and various customer service feedback options.

Further improvements are also planned in the referral period as part of our business-as-usual operations. Costs associated with these improvements will again be absorbed by Valuation Services.

It is assumed that there will be no fundamental changes to the scope, framework and methodology for conducting valuations in the referral period, including the introduction of capital improved valuations. Improvements to the standard of service include the completion and implementation of the recommendations of the Joint Standing Committee on the Office of the Valuer General. At the 11th joint standing committee meeting, seven recommendations were made and subsequently supported by government. Recommendations from the 12th joint standing committee meeting are currently being considered by government.

The Valuer General and Valuation Services have been working with the Cooperative Research Centre for Spatial Information in collaboration with the University of New South Wales. The Valuer General is conducting research into the potential application of rapid spatial analytics and visualisation technology for valuation and property analysis processes. This project offers the potential to develop new approaches for making and testing the quality of valuations.

The valuations system remains largely unchanged. The operating expenditure is cost efficient and valuations correlate closely with the market. A review of Valuation Services' quality assurance for 1 July 2018 by Adjunct Professor John MacFarlane found that the quality assurance program was delivering high quality valuations.

The Valuer General is considered a low-cost service provider in a benchmarking study undertaken by the International Property Tax Institute in 2015.

Moving on to the referral period, the total notional revenue requirements for local government is calculated to be $109 million over the six-year period. To calculate the revenue, we used IPART's cost building block methodology, which assumes that all costs are incurred including operating expenses; return on assets; depreciation; tax allowance; and working capital. These components represent the Valuer General's total efficient costs over the referral period for the provision of valuations to councils.

There are a number of risks that the Valuer General faces over the referral period which may result in the actual cost of service provision being significantly different from the estimates. These risks include:

The cost of implementation of a new database and other business system upgrades;
Significant changes in the property market, which can lead to significant increases in objection volumes;
Externally mandated increases in quality - for example, a decision by government to implement a recommendation by the joint standing committee.

We submit that should costs vary significantly from the final determination, we may need to make a further submission during the referral period.

Valuation Services also provides valuations for compulsory acquisitions under the Land Act (Just Terms Compensation) Act and private valuations. Valuation Services has a separate just terms and private valuation team. Hence these direct costs have a separate cost centre. Indirect costs of the just terms and private valuations team are apportioned out on an FTE basis. These costs are ring-fenced and not included in the calculation of prices charged to councils.

There are also a number of minor users of valuations, including private brokers and the general public and other government agencies, such as NSW Fire and Rescue, NSW Roads and Maritime, NSW Crown Lands and Local Government Grants Commission.

With the exception of NSW Roads and Maritime and NSW Crown Lands, the valuation services provided to minor users represent a more basic service than that provided to councils and to Revenue NSW. Therefore, minor users of valuations are not allocated a proportion of costs for valuation services as the amount involved is not considered to be significant.

Most of the forecasting methodologies proposed by the Valuer General in the 2014 IPART review are still considered to be appropriate and have therefore been applied in our proposal for the referral period using 2018-19 as a base year.

Analysis of each operating expense has led to a percentage cost allocation for each category. For the referral period, the allocation of costs to councils is set at 32.5 per cent compared with 34 per cent in the current determination period.

The majority of operating expense allocations are based on a 33 per cent share of the frequency of valuations to councils over the three-year cycle. The forecast capital expenditure over the referral period reflects two significant business transformation upgrades that have been submitted to treasury for approval.

The first is the digitisation of land valuation notification delivery consistent with the government's mandate to transition to digitised service offerings with Service NSW. It is expected to cost $2.4 million and be fully implemented by November 2019 to coincide with the land valuation notification cycle.

The second is the implementation of Valnet III to replace the current combination of database application and exclusions. Valnet II is an out-of-date system built in 2000, which has seen additional functions and enhancements added over years to meet changing business demands and needs.

A new system would reduce the risk of system failure and provide a more efficient higher quality product to councils. Subject to treasury approval, a business technology transformation is proposed over the next five years with an estimated cost of $26.2 million.

In accordance with our objectives, we believe that the preferred approach is a differential pricing model based on four geographic regions, with one price for each region irrespective of the property type.

The reason for this change is that 41.3 per cent of total costs can be attributed to geographical areas. Those costs, for mass valuation and objection contractors, are market tested through a robust procurement process. This more clearly reflects a user pays cost of delivering service.

The total price per property in 2018-19 real terms for the four regions is:

City of Sydney, $12.71;

Metropolitan, $6.06;
Country, $8.24;
Coastal $6.92.

Previous contract prices clearly show a difference in the cost of services for metropolitan and country regions. Overall the current cost per valuation is lower in metropolitan areas than regional areas due to the higher number of residential properties in metropolitan areas and the cost of travel in rural areas.

The City of Sydney local government area is an exception. This is understandable given the City of Sydney comprises the highest valued and most difficult to value properties in the state.

We recommend the differential pricing model as it:

Results in fair and efficient cost allocation between councils;
Is based on a more comprehensive analysis of cost drivers;
Has the ability to more accurately segment the market to better reflect the cost of servicing for each regional area;
Minimises cross-subsidisation of rural areas and the City of Sydney Council by metropolitan areas;
Is simple to administer.

The current 41 contract areas have now been amalgamated into 18 areas in the latest tender round. The economies of scale and increased competition generated are believed to deliver management efficiencies, better quality valuations and a reduction in costs. Unfortunately, the details of the results of the tender cannot be released at this time.

In summary, our proposal will:

Ensure recovery of the Valuer General's efficient costs;
Fairly and equitably distribute costs between councils and Revenue NSW;
Include an initial increase in prices of 2 per cent in real terms;
Index prices by CPI;
Apply one price for each of the four geographic

regions, reflecting the relative cost of delivering those services.

Thank you.

THE CHAIRMAN: Thanks very much for that, Michael.

We will now open up for points of clarification. I would remind people that we have scope for detailed discussion on the items that will be raised in the three sessions that will follow. For now, could people confine their remarks to points of clarification from Mr Parker's remarks.

Let's proceed to session 1, which looks at the Valuer General's efficient costs. Thanks for your presentation on that, Michael, and thank you for the clarity you provided.

We will now seek your views on the proposed costs of providing valuation services, including the Valuer General's proposed operating and capital expenditure as has been outlined.

I will hand over to Regina Choi to introduce this session. Regina, from IPART, thank you, if you could introduce the session and then we'll open up for comments around that.

Session 1: Valuer General's efficient costs

MS CHOI: Thank you Paul. Good morning all. I will be introducing today's session on the Valuer General's efficient costs.

As a quick overview of IPART's role in this review, the premier has requested IPART to determine the maximum prices that the Valuer General can charge councils from 1 July 2019.

We have received the Valuer General's proposal and eight stakeholder submissions and, as we assess these, we will take into account the pricing impact to customers when setting the prices to recover the efficient costs of the Valuer General.

IPART last set the maximum prices for a determination period of five years, which was effective from 1 July 2014 to 30 June 2019.

For the upcoming determination, the premier's referral period is for six years and the Valuer General has proposed a single six-year determination which will cover two three-year valuation cycles. Alternatively, we could consider two three-year determination periods, as suggested by some submissions.

In setting prices, we are using the cost building block approach to calculate the Valuer General's notional revenue requirement - or what we call the NRR - of providing all land valuation services including for rating and taxing purposes.

On this slide we, can see that the key components of the building block model are:

The allowance for working capital;
An allowance for return of assets;
Allowance for return on assets;
A regulatory tax allowance; and
An operating and maintenance expenditure - opex.

Once we have set the appropriate NRR, we will then allocate a proportion of this revenue that is required to service councils for rating purposes only, and this is the monopoly service component for which we are setting prices.

In allocating costs to councils, we will consider how much and how frequently the Valuer General's services are used by councils.

We found that the Valuer General's services is a labour-intensive business, whether that be by contract or direct labour. In the 2014 determination, opex made up around 94 per cent of the total NRR allocated to councils. In relative terms, this meant that, out of an average annual NRR of $17 million, $16 million was made up of opex. For the 2019 determination the Valuer General has also proposed that opex can make up 94 per cent of the NRR allocated to councils.

Looking at this slide, the key components of the opex are labour costs of 32 per cent, and the mass valuation of 41 per cent. As the Valuer General has advised, the mass valuation contract costs are currently being finalised.

Once that is done, IPART will be considering any changes to costs in our review.

Compared with the last determination period, the proposed average opex is 6.5 per cent higher. The key drivers of this increase are from labour costs and other valuation contract costs, the main components of which are objections and quality assurance audit costs.

Moving on to the capex, if we look on the left-hand side of this chart, we can see that the actual capex that the Valuer General has set, shown by the blue bars, was significantly less than the capex used to set prices in 2014, and that is in the dark grey bars.

Going forward, the Valuer General is proposing an increase of 142 per cent from the average annual capex of $1.9 million, determined in 2014, to $4.6 million for the upcoming six-year period. From this chart, we can see that the majority of the capex is forecast to be spent in the financial years ending 2021 and 2022.

As was mentioned in the Valuer General's proposal, the key driver of this increase in capex is from the proposed IT transformation project expected to cost $26.2 million and the digital offering of $2.4 million.

Based on the Valuer General's proposal, the operational benefits from the IT transformation project will be realised from year four of the referral period and the digital offering benefits will be realised from year one. The proposal also states that these savings have been reflected in the proposed prices.

If we go back to the cost building block model, with 94 per cent of the total revenue requirement made up by opex, the remaining 6 per cent is made up from the return on capital; return of capital; return on working capital; and a regulatory tax allowance.

For discussion, we have several questions on which we are interested to hear your feedback. These questions relate to the length of the determination period, the Valuer General's proposed opex and capex costs and approach on setting the regulatory tax allowance.

I will now hand back to the Chair, thank you.

THE CHAIRMAN: Thank you, Regina.

We now have about 25 minutes to raise points relating to that presentation on the notional revenue requirement - that is, the underlying costs that need to be recovered. What I'll do is open up to people around the table, for a start, for any comments they might like to make, and then we will move on to people on the floor. So, let's go from here.

MS FLYNN: Suzi Flynn from the City of Sydney. I have two quick comments, or rather a question and a comment.

Firstly, with regard to the cost of the new and more efficient contracts and how they will impact this pricing, when will that become available? I think the new contracts are to commence on 1 March, so I am assuming that will be shortly.

Secondly, with regard to the IT systems upgrade, Valnet II, has been used quite well. Yes, it is an older system, but the driver for changing that to Valnet III has not come from local government. We would probably appreciate some more information on what those benefits to local government will be.

MR PARKER: If I can take second question first, in regards to Valnet III. The Valnet II system was developed in 2000. There have been a lot of add-ons in process and procedures. It is very clunky to use. It is unsupported. Parts of the system are actually unsupported, as in out of date with the supplier, and the technical advice we are getting is that there is a risk in maintaining this system for too long. We would all appreciate that technology moves on and 2000 is a long time ago in terms of technology.

We think there will be benefits to councils in the services we can deliver and efficiencies just through using the system that may pass on to prices eventually.

MR SZABO: Dennis Szabo, Property NSW. I'll take the first question.

As you say, the proposed new contracts will commence on 1 March. We are in the final stages of awarding contracts. We propose to update IPART with the new prices, once those contracts have been executed by both parties. We are expecting that to occur, in terms of contracts, in the next week or so and overall we are expecting a good result.

THE CHAIRMAN: Are there any more comments around the table? Could I ask people to introduce themselves when you commence.

MR BUTCHER: My name is Andrew Butcher. I am representing the NSW Revenue Professionals.

Following on from Suzi's comments, from the City of Sydney, we support the price determination for the six years, but separated into two three-year determinations, acknowledging, however, that the Valuer General may experience some variations in its costs during that period.

With regard to the IT infrastructure or the upgrade of Valnet III, we also acknowledged that there may be a need for that. We do not want to regress back to days when quality of valuations or the valuation service could suffer due to not having an appropriate system. How those costs ought be allocated is a matter that we will probably raise later on in the final discussion period.

I think that's all I have to say with regard to the discussion slide. Thank you.

MR McBRIDE: Shaun McBride from Local Government NSW.

We slightly differed in terms of the determination period. We favoured a six-year determination, based on the experience of the last determination, which successfully lasted five years. We think it would be simpler and less resource intensive just to go through a six-year determination. However, we are aware of the provision that, if anything significant were to change, there is the opportunity for a supplementary price review, should that occur.

In the last five years, there have not been any significant changes, apart from the fire and emergency services levy excursion, which may return one day but maybe not for a while. So we are not in disagreement, but we have just taken a slightly different approach to that.

We are concerned about the 2 per cent increase in real terms. It would appear that that has to do with capital expenditure. We would like probably a fuller explanation of what is behind that additional increase. Thank you.

THE CHAIRMAN: Thank you. Are there any other comments around the table?

Let's move to the floor. Have we got any points of clarification required or comments from people on the floor of the meeting? Deborah Cope, please.

MS COPE: I was wondering with regard to the difference between two three-year periods and six years, what is likely to change between those two three-year periods? What sort of risks of significant cost increases or decreases do people think there are or has, historically, the environment remained relatively constant across the different cycles?

MR PARKER: The reason we propose the six years is that we believe we can forecast out to that point. However, we accept that government may make a decision to introduce changes that obviously any pricing system will not be able to absorb.

There have been discussions in the past about introducing capital improved valuations. If the government were to move to that process, certainly the Valuer General would have to resubmit on that basis.

The six-year cycle sits with our valuation tender process. It sits with the cycle for council rating, which has now been harmonised. Those are the reasons we went with the six years. We think that the system is generally stable enough to have a determination that lasts six years, albeit we appreciate that those big changes may be introduced.

THE CHAIRMAN: Thank you, Michael. Yes, Matt?

MR EDGERTON: Matt Edgerton from the IPART secretariat.

Michael, I have a point of clarification. In terms of your additional capital expenditure, could you tell us how much of that is driven by the need to essentially maintain current service standards versus being driven to increase service standards?

MR PARKER: That is a very difficult question to answer in terms of sums. I am not a technician in terms of what the costings are in relation to different parts.

The reason for the expenditure on Valnet III is mostly driven by the fact that this is an ageing system that is unsupported and very clunky to use. Rather than introducing any huge change to the actual database and function, it is about modernising the processes we have in place.

Having said that, there will be aspects, we hope, of the new system that will allow for innovation that could move to, say, a capital improved valuation process, if that is possible. As far as the scope, we have not actually developed that to the point of knowing exactly what this is going to be yet, so it is still at a fairly base level. As to the understanding of what we need to add on just to be ready for those sorts of things and how much that costs over and above what is the standard database and provision of services, I can't really say.

MR EDGERTON: Sorry, I have one more clarification question. In terms of cost drivers, drivers behind increases in cost, we are talking about capital expenditure. Could you tell us a little bit more about what the drivers behind increasing operating expenditure are.

MR PARKER: There were a number of events that impacted on the budget over that period, including the introduction of the fire and emergency services levy. There were implementation costs there and extra labour costs of around $1.9 million. There were changes to the way long service leave was treated for staff, so the labour cost increased by around $2 million. There were various events that impacted on the provision of our services. But, again, that was absorbed and not passed on to the councils.

MR EDGERTON: And going forward, over the forward period?

MR PARKER: We are hoping we will not be visited by the fire and emergency services levy, or any similar situation over that period. We can't foresee what we don't know.

Some of the costs - if I could just look at my notes here - related to the numbers of objections that were above our estimates. That is not something we have control over. People have the opportunity to object. We try and predict those numbers, but circumstances can change. One of the risks we face is that there can be a change to the market that actually promotes more objections. When the market considerably falls or considerably increases, we find that we get increased numbers in objections. So there are elements to that.

With regard to rental, there were properties that we had to vest to Property NSW, and that changed the way we were charged rental. So there was a different arrangement there. That all sort of added up to the $10.2 million.

THE CHAIRMAN: Thank you, Michael. We have some further questions from the secretariat.

MR MADDEN: John Madden, IPART.

I want to touch on the IT expenditure - Valnet III. You mentioned that you were at a base level in terms of planning. Could you discuss or outline the process you have to go through from here and, also, I guess, the uncertainty around that estimate that may exist.

MR PARKER: I might pass that question on to the executive director.

MR SZABO: Indeed we have gone through a process of understanding the broad base of costs that we put into the submission. We had assistance from an external consultant to do that. We have submitted a preliminary business case, essentially to treasury and we have a series of gates to go through.

The next phase of the program is to actually go into a little bit more detail on that business case, which means understanding the scoping and having a number of conversations with the market around what is essentially out there in terms of possibilities for a new system and working back to transitioning from the current need to what is possible with the new system. We are at the early stages, essentially.

MR CHAPMAN: Scott Chapman, IPART.

On the mass valuation contracts, we note that they potentially make up the largest proportion of the operating costs. You are in the process now of finalising a whole new procurement process and structure with regard to the way that you have set out those contracts. Maybe you could expand a little bit on the drivers of changing or the rationalising of those contracts and what the benefits might be, or otherwise.

MR SZABO: Is this around mass valuation contracts?

MR CHAPMAN: Yes.

MR SZABO: Sure. In terms of the logic, let me give some context, I suppose, from the beginning. We currently have 41 valuation contract areas. In 2017 there was a review of the whole contracting strategy. It is important to understand that, in that context, we had regard to a number of different elements. One is that, although we have 41 contracting areas at the moment, we actually have 19 contractors. We have also observed quite a bit of consolidation in the market.

In terms of the approach, we had a number of face-to-face discussions with our contractors to understand what it is that they will be looking for, what areas they would be prepared to support. Essentially, we have rationalised it down from 41 contract areas to 18.

In terms of our approach to the market and what we were looking to achieve, obviously with a big procurement project like this, there are a number of objectives and benefits we were looking to achieve, including better value for money, driving economies of scale, interestingly, reducing the barriers of entry. One of the responses from our contractors was that the contract areas were quite small and that precluded them from actually amortising some of their fixed costs and start-up costs.

We also wanted to improve the efficiency in which we manage these contracts. So managing 41 contract areas versus 18 contract areas, there is a bit of difference there. Thank you.

MR CHAPMAN: You mentioned that Valuation Services had moved, I think it was in 2015, from LPI to Property NSW. Has that changed in any way the overheads of Valuation Services, or the overhead costs of the structure of the new organisation that Valuation Services has to bear?

MR SOO: Kevin Soo, Property NSW. I will take that question.

Essentially, with the move from LPI to Property NSW, Valuation Services is still within the Department of Finance, Services and Innovation cluster. The way that the cluster appropriates its costs in relation to overheads - being finance overheads, HR overheads, procurement, legal - is based on a corporate cost allocation model, which is driven by FTE drivers, expense drivers. Regardless of where Valuations Services sits, whether within LPI or Property NSW, it would attract the same amount of overheads.

MR MADDEN: As a supplementary, coming back round to IT, you mentioned the process, and I am just wondering about the uncertainty around the cost estimate from the external provider and any internal work. This far out, generally this kind of scenario is tested and you have an upper or lower limit. Does this represent a mid-range estimate of the project cost that is included in this proposal or how would you describe it?

MR SZABO: When we went through the process, we did get a mid-pointed estimate from the external consultant. That was then reviewed by our internal IT teams. The consultant suggested that, because we had been provided with a single point estimate, we add a provision or a contingency of 25 per cent, which is what we actually did.

It is important to understand the components of the $26.2 million as well. Essentially $22 million of the $26 million relates to the infrastructure, and about $4.3 million is around business process re-engineering.

We absolutely recognise that when you are going to introduce a new system, the processes around that new system will need to change. In the submission we have actually outlined some savings that we expect would occur from making our processes more efficient around that system. We have also estimated that some of those savings may come from contractors; ie, when we interact with them.

Currently it is through, let's just say, batch processing of data. It is not directly linked into their system. We are envisaging that, with the new Valnet III, we would be providing the IT infrastructure for them to directly input their analysis and their data sets and anything else we need. So we would expect that there would be some efficiency that the contractors would also benefit from and, accordingly, we have estimated some of those savings in our submission.

MR CHAPMAN: I have one follow-up question. Sorry to harp on IT. It is notoriously tricky.

I note in your proposal you have proposed effectively to do most of the capital expenditure and the purchase and implementation or embedding at least of Valnet III in years two and three of the six-year determination period. Essentially all your capital expenditure will be almost done by 2021-22, I think it is - so by the third year of the six years.

At what point do you envisage that that system will be commissioned and implemented and fully up and running to realise the potential for forecast efficiency gains that might flow through from that timing-wise?

MR SZABO: Thanks, Scott. As you mentioned, most of the expenditure would be completed by 2021-22. We envisage that the system would be operational towards the beginning of 2022-23. We still have some expenditure that we have included there. We are showing some savings from our operating activities from that 2022-23 year into 2023-24, and again 2024-25.

It is important, when we look at a new system and switching over, that we make sure that it is properly tested. We also envisage that we would be running the system in parallel for at least 12 months, just to make sure that the expectation of the new system actually meets what we need to have in terms of deliverables. We will have a fall-back just in case something goes awry. In terms of risk management, we have thought that through as well.

THE CHAIRMAN: Are there any further questions, comments clarifications?

MS FLYNN: Yes, I have a couple.

I understand that when the fire and emergency services levy was going to be introduced, there were some difficulties with systems between the different state government departments not speaking well to each other particularly between Valuation Services and Land Titles. My question is: how much scope, if any, has been included in Valnet III to better integrate with the other departments?

Also, Michael, you mentioned that there might be the ability to make a smoother transition to CIV with Valnet III, so is that a real possibility with Valnet III?

Lastly, could the additional requirement - if there is one - for contractors to interact with Valnet III actually reduce the amount of contractors that would be willing to service Valuation Services and therefore would that increase prices?

MR PARKER: If you have a look at the network of Valnet III and all the different systems that it connects with and interacts with, it is just a spider web. Again I am not a technician, but providing a system that actually is current enough to deal with other systems that have been changed and developed is part of the reasoning that we have to develop a new system.

I am not sure of the particular example you are talking about with Land Titles, but that is part of the reason we need to modernise; namely, to be able to keep those interactions going.

Sorry, three questions is two too many for me.

MR SZABO: The CIV.

MR PARKER: Again, we have not actually said to a developer, "This is what we need for CIV". We understand that CIV is out there. It is being considered by government and it could be introduced. It would be rather negligent of us to not actually put something in place that could at least react if that were going to happen.

I think, in the development of the system, we would be saying to the developer, "There is a possibility of this coming along. We don't want a gold-plated introduction of that, because it does not exist yet, but you have to allow for the functionality for that to proceed if in fact that did happen." And the first question?

MS FLYNN: It was about the contract valuers needing to interact with Valnet III.

MR PARKER: Currently the contractors use proprietary products. There are five or six in the marketplace. They pay a licence fee for that, or they may own it and then they are responsible for the development and upgrade. If the new system developed a process where it was more streamlined and connected or they could feed off it, that would resolve some of their issues as far as IT and maintaining systems.

I do not know whether it would be mean there would be fewer contractors. In fact, it may open up opportunities to more groups who do not want to be involved either in developing an IT system or maintaining an IT system. As I said, it can reduce their costs if they do not have to pay a licence fee.

MS FLYNN: Thank you.

MR CHAPMAN: May I ask one follow-up question, Mr Chairman?

THE CHAIRMAN: A nice quick one.

MR CHAPMAN: Yes, it will be quick.

You mentioned there will be potential cost savings for contractors who are doing mass valuation, for instance, with the implementation of Valnet III. Were they made aware through the procurement process that Valnet III may be implemented and those cost savings could be factored in to their bidding and tendering for those contracts over this coming period?

MR SZABO: I'll take that question.

The answer is no. The procurement process was well underway before, I guess, we landed on the review of Valnet II and explored the possibilities around that. I guess the logic that we have around this submission and the possible savings we could make from our contractors is in year six of the contract term.

The contract is five years and with a one-year option, so we would envisage that, by year three or four of that contract, we would have a good understanding of what the system would look like and we would be able to pitch to the contractors the benefits of that system and have a discussion, negotiation around whether the government decides to extend that additional year in that contract term or whether we would go to market and start all over again.

MR CHAPMAN: Thank you.

THE CHAIRMAN: Having discussed the efficient costs, the notional revenue requirement, we will now move on to talk about the allocation of costs to councils.

Scott Chapman, from the secretariat, will give us some introductory remarks on that, and then again we will open up for comments and queries.

Session 2: Allocating efficient costs to councils

MR CHAPMAN: Thanks, Chair.

As Paul just mentioned, this session will be about the efficient costs of the Valuer General, and Valuation Services, undertaking all of the services that are to be delivered and what proportion of those costs should be allocated to councils for the monopoly services for which we will be setting prices from 1 July 2019.

As Regina stepped through in the previous presentation, IPART will need to be making decisions about what the total efficient costs of the Valuer General's services are, referring to services to all of their users.

Our role in this review is to set prices for the monopoly services component of those services, which is just the services to councils for rating purposes. Therefore, we need to come to a landing on what proportion of those efficient costs gets allocated to councils.

The Valuer General had proposed this time around that 32.5 per cent of those total efficient costs be allocated to council and, by extension, 67.5 per cent would be allocated to the other users of the services, including primarily Revenue NSW, but also other users.

This table gives a comparison on the decisions that IPART made in 2014 in terms of the activities the Valuer General undertook and what proportion of those cost items it allocated to councils, therefore, the balance is allocated to other users, including primarily Revenue NSW.

In the Valuer General's proposal, it is proposed that two of these key cost items, including labour costs and other valuation contract costs, change from what we decided in 2014. Labour costs will go up from 33 per cent to 36.5 per cent and other valuation costs will drop from 50 per cent allocated to councils to 38 per cent.

We have a whole range of other cost items on the slide which essentially set out all of the costs that the Valuer General incurs in terms of operating expenditure. We have mass valuation contracts of 25 per cent. Mass valuation contracts are the largest proportion of the Valuer General's total costs and they have, in line with our previous determination, allocated 25 per cent. There is a whole range of other ones at 33 per cent and a couple at 100 per cent. When that it is weighted out, it means that, essentially, in the proposal, 32.5 per cent of the total costs are allocated to councils in this respect. Therefore, it is that 32.5 per cent of the total costs which we use to set the target revenue for each year and, flowing on from that, the revenue that needs to be raised through pricing.

Briefly, this slide gives just a bit of a discussion guide:

> Is there any reason to move away from the current approach of allocating costs to councils?

That refers to those line items in the expenditure that can be individually identified and allocating a percentage of each of those costs to councils.

Secondly, under each of those items:

> Is the Valuer General's proposed cost

allocation to councils reasonable?

And a specific question:

Does the current allocation of the Valuer General's costs to councils appropriately reflect the servicing of minor customers?

Those percentages that were on the previous slide essentially allocate costs between council and Revenue NSW.

It has already been mentioned by the Valuer General that there are other minor users of the services, including Roads and Maritime and NSW Crown Lands and a couple of others. Should perhaps part of that be allocated to those customers as well?

Thank you. I will now hand back to the Chair to commence the discussion.

THE CHAIRMAN: Thank you. Are there any points from around the table, first up?

MR McBRIDE: I have just a couple of points.

As in our submission to the last determination, we are certainly of the view that the minor users - and some of them are significant minor users - should be paying a larger part of the costs of the service that they are benefiting from.

We have recommended that they also - particularly ones like RMS and Crown Lands, who are quite large - be charged average cost rather than the marginal cost approach that it currently being applied. Thank you

MS FLYNN: The City of Sydney has a number of points to make about the allocation of costs to councils.

Firstly, the 33 per cent, which is based on councils receiving valuations every three years, does not make sense because if we are receiving valuations every year or if they are required every year, as Revenue NSW does, we would not be paying 100 per cent; it would be 50:50, I imagine, on this calculation. So the ratio should really be 50:50, perhaps for the first year and then nothing for the next two years. Therefore, out of the three-year cycle, I think the percentage would be closer to 16 per cent for local government.

I would say that the same would be true for most of the costs that you have allocated at the 33 per cent mark. Focusing on graphic services and postage costs, I think it is unreasonable to allocate 100 per cent of the costs of both to local government.

I wish to refer to some points we made in our submission. Graphic services will send out valuations to landholders, but they will also send out the objection kit. It is my understanding that objections are not just for local government. They would also be in terms of land tax and, therefore, a large proportion of those objection kits, and graphic services, as well as the posting of those same items, should then be allocated on the same basis.

For graphic services, on the numbers that the Valuer General put in his submission, it would be roughly 35 per cent to local government. With postage we had 46 per cent. On that, though, I would like to question how the number of valuation objections based on local government versus rates versus land tax is captured. The number allocated for local government rates appears a bit high. There were some allocated in both the off years. Here are two years that councils do not receive revaluations, yet a large proportion of valuation objections is still forecast to local government in those years, which is out of kilter with the legislation that says they need to be made within 60 days. We would like some further explanation on that.

There was also some mention in the Valuer General's submission about the changes to contract requirements and that that would lead to increased costs. We would be asking what those changes are, because we are not sure what they are, that have increased the contract costs.

There was one mention that was specifically in relation to the City of Sydney. It was stated that there were annual verifications done on land values. If that was something that was required by Revenue NSW, then that would probably be a part of that cost that should not be allocated to local government.

MR SZABO: I might go backwards, if that is okay, with what is most current in my head, which is around the split of the objections, how we have reached the 38 per cent.

In the current period, we had an enhancement done to Valnet II which allowed us to look back at the volume of objections for rating versus taxing. We essentially looked back 10 years. We looked at volume and we realised that the spread is 37 per cent to local councils. We landed on 38 because we have allocated the quality control processes around objections 50:50, so that is essentially an extra 1 per cent. That is the answer on the 38 per cent question.

In terms of the direct 100 per cent allocation on graphic services and postage, Revenue NSW essentially distributes their own notices. We do not do that for them. Consequently, that is why all of those have been allocated to local councils. We recognise that part of the postage involves posting out objection kits, et cetera. We have estimated that at around, I think, $20,000. For a cost base of around $2 million for postage, that is equivalent to sort of 0.1 per cent difference in the allocation. Therefore, it is really, from that perspective, minor.

I might now go to your question on the allocation for the other costs based on a 16.7 per cent suggestion, and I will approach it, as you have, from around the 50:50 split. We are sort of fortunate that we have two customers who use essentially the same valuation data set. On that basis, over the long term, we would expect that that would be split 50:50. Maintaining the register, the quality assurance programs around that and the supplemental valuations that are produced for both parties would suggest that 50:50 split.

I understand the logic behind the 16.7 per cent, but. I guess we view that as councils looking at the incremental cost of producing mass valuations only. When we look at what we actually do and the availability of the valuation system for councils to tap into every three years, that needs to be taken into account. With the fixed costs around maintaining the system, maintaining the IT infrastructure, to have the people there and available to value every three years, there needs to be an availability charge concept considered.

We also consider that while we only do valuations for councils predominantly in that general valuation year, in reality, we actually provide councils with updated files for those general valuation years on a weekly, fortnightly and a monthly basis, because we update those files for consolidation, amalgamations, subdivisions, objection changes, and we ascertain them. In reality, the councils are getting data every year - constantly, and every year - from Valuation Services.

That is essentially why we feel that while, on one hand, you could argue for a 16.7 per cent allocation, these other services that we provide in the intermittent periods need to be taken into account, including customer service to councils; hence why we have landed on the current 33 per cent allocation.

THE CHAIRMAN: Are there any further comments or questions? Yes, Andrew?

MR BUTCHER: I want to say that NSW Revenue Professionals is a body that represents all New South Wales councils. The City of Sydney is clearly an active participant in that group. Suzi has pretty much covered all of the points that I was going to raise, but I would like to go over again the postage and the graphic services.

I think that what Suzi has said is quite correct in that with regard to those charges, the Act is quite clear that the Valuer General is to provide valuation notices for any rate or tax. Even though we have heard that Revenue NSW issue their own notices, that still could trigger a response from the community that, "This is my land valuation notice. It is going to affect my land tax debt". So we think that the cost split or 100 per cent share to councils is probably not a true representation.

Also, with regard to the objections, we would probably like to see some more information as to how that data has been collected. If a member from the community receives a valuation notice and has a mindset that it will affect their land tax but is relevant to their council rates immediately they may identify with an objection to their land rates in that process and not necessarily make it clear that they are also objecting on the valuation of the land tax.

Apart from that, I echo what Suzi has said and that is in our submission as well.

THE CHAIRMAN: Thank you. Are there any further points or comments?

MS FLYNN: I would like to ask again what are the changes to the contract requirements that were mentioned in the submission? Has it increased contract costs as a result?

MR SZABO: Sorry, is this mass valuation, is it?

MS FLYNN: Yes.

MR SZABO: As I understand the changes in that contract, they are going to be around quality and increased scope of services.

THE CHAIRMAN: If there are no further questions or comments, we will break for morning tea and we will come back at 11.25 for session three. Thank you.

SHORT ADJOURNMENT

THE CHAIRMAN: Welcome back and thanks for your comments to date. We will now launch into session 3 on prices, price structure and the impact of the proposed price structure. Kumi Cuthbertson, from the secretariat at IPART, will guide us through the discussion. So, Kumi, over to you, thank you.

Session 3: Prices - Structure and impact

MS CUTHBERTSON: Thank you, Paul.

As we discussed in the previous session, the first step in the review is to establish the total efficient costs for the Valuer General. Then, following that, we make decisions on how to allocate the monopoly service costs to councils for rating purposes.

In this session, we are going to look at how we will set prices to recover the efficient costs allocated to councils. These are the maximum charges for the valuation services provided by the Valuer General to councils.

In the next few slides, I am going to look at some alternative pricing structures that the tribunal could consider and also the impact of some of these structures on councils.

Under our terms of reference for the review, we are required to develop an efficient, effective and transparent pricing framework, as we saw in one of the earlier slides. Based on that we have identified some key criteria or guiding principles in terms of setting our pricing structures and making decisions about prices.

While this is not a comprehensive list, we think that some of the key guiding principles are:

Cost reflectivity, which basically means that we should ensure that the customers who are incurring costs should be the ones who are paying for those costs;
Efficiency in implementation, which means that the administrative or implementation costs should not outweigh any of the benefits of IPART's methodology;
Transparency in setting prices - in other words, prices should be easy to understand and the methodology should be easy to understand and easy to explain:
As well as that, we need to be consistent in our approach in setting prices.

Our previous determination set uniform prices across New South Wales, basically a postage stamp price, which was a single price for residential and a separate single price for non-residential valuation, which applied across all of the councils in New South Wales.

If we retain the uniform pricing model that we have had in the past, the Valuer General has proposed some prices based on that, as discussed, with a 2 per cent real increase. Those prices would be $5.99 for residential and $13.17 for non-residential as compared with the previous $5.87 and $12.91 respectively.

However, in the determination, as we have heard earlier, the Valuer General has proposed moving to a new system - a new differential pricing methodology.

The Valuer General has proposed a single price for both residential and non-residential valuations, but the price would differ based on the region in which the council is located. Under that proposal:

Country would pay $8.24;

Coastal councils would pay $6.92;

Metropolitan councils would pay $6.06; and

The City of Sydney would pay $12.71 for valuations in their local government area, regardless of whether it is a residential or non-residential valuation.

This is a map that the Valuer General also showed us. It is just a quick reference to how the four regions look like in New South Wales. Basically all that green area is the country region, which takes in most of the councils. You have the narrow yellow strip for the coastal regions, as well as metropolitan and Sydney in that little red dot.

By means of a little bit of background - and the Valuer General did give us some information on this - the Valuer General outsources valuation services to external service providers through a tendering process. These valuers determine land valuations for identified geographical regions across New South Wales.

We heard that there are 41 mass valuation contract areas which will now be narrowed down to 18 mass valuation contract areas. Those 18 mass valuation contract areas, you can see in the barred columns on that graph. They are basically the light blue, the dark blue, the orange and the green which show country, coastal, metro and the City of Sydney. You can also see the yellow line which represents the average price for each of the contract areas. Based on those average prices for each of those 18 contracts areas, the Valuer General has come up with those prices that we looked at before for the four geographical regions.

The Valuer General, in his submission, did state that regardless of whether the tribunal adopts a uniform pricing model or a differential pricing model, the revenue, from his point of view, is neutral; in other words, there is no material difference in revenue. But the Valuer General did tell us that the reason for preferring the differential pricing level is that it is more cost reflective of costs that are actually incurred for providing those valuation services to councils.

Some of the other reasons for going to that model, as cited earlier, were things like the reduction in cross-subsidisation of rural and the City of Sydney by metropolitan councils. We also heard that it is administratively simpler for councils to provide total property data rather than having to provide the split of residential and non-residential data for invoicing purposes.

However, there will be cost implications in going to a differential pricing model and that will depend on each individual council's mix of property types.

You can see in the slide here, looking across the four regions and comparing uniform pricing with the differential pricing, that the aggregate bill for councils in the country regions would increase by about $1.5 million, or 5.5 per cent, over the whole referral period – that is, a six-year period. Likewise, the aggregate bill for coastal and City of Sydney would increase by around $1 million over that six-year period. The aggregate bill for metropolitan councils, on the other hand, would decrease by around $2.4 million, or around 7 per cent, over the six-year period.

Having said that, this is an aggregate bill, so individual councils will be affected differently in each of the regions depending on their mix of residential and non-residential valuations.

If the tribunal decides to adopt a differential pricing model, there are potentially some additional models that we could look at. Number 2 on the left of the slide is the Valuer General's proposed model with the set price for each of the geographical regions. There is only one price for residential and non-residential valuations, and this was based on the fact that because of geographical locations, around 41 per cent of the costs were driven by the location of the council.

However, in assessing the pricing options, we could look at other cost drivers, for example, property types, which is another cost driver - maybe not 41 per cent, but it is another cost driver. Is it more costly to value a shopping centre or something that is way out in a rural area?

In the interests of better cost reflectivity, we could consider potentially a residential and non-residential price within those four zones, or we could even look at going to 18 zones and perhaps that would be more cost reflective - 18 zones with either one price across residential and non-residential, or two prices, one for each. But we would have to assess that against our pricing principles.

There was another model that was proposed in the submissions. This was proposed by some of our stakeholders. This model is like a common charge model which was calculated on the basis of dividing the total revenue requirement for the Valuer General by the number of valuations across New South Wales. Using that model, the submissions cited a price of $6.95 per valuation, regardless of whether it was residential or non-residential, across all of New South Wales. Adopting that, again, could be something to be considered, but we would have to weigh that up and assess that against the pricing principles.

That concludes the session on pricing structures. For the purpose of discussion, we have come up with a few questions which you can see up there on the slide, revolving around pricing principles, whether or not these are adequate or relevant, whether or not we should change from a uniform pricing model to a differential pricing model, or some other model, and what would be the best type of price structure - residential, non-residential, mixed, et cetera? What is the best price structure we should come up with, basically.

I will hand back to the Chair to continue the discussion.

THE CHAIRMAN: Thanks, Kumi. I will open up the discussion now for people around the table and then go to the floor.

MR McBRIDE: I with to make a few points in relation to the issues raised. We do note that this is not material, it is sort of tangential to the Valuer General's revenue requirements, so it somewhat takes us away from the main purpose.

In relation to the pricing principles, it would seem that the current system probably best serves three of the four pricing principles - efficiency, transparency and consistency. It is certainly simple to understand. In terms of cost reflectiveness, on a regional basis perhaps not, but on a state-wide basis, it certainly is.

We do note, as we have in our submission, that the previous determination determined that non-residential valuations were more costly to produce than residential valuations, and we are not sure that anything has changed in that regard.

In relation to the overall changes, particularly the different regional rates, Local Government NSW is a peak body representing all the councils in the state. I would have to say that, at this point of time, there is no consensus among councils for that change, naturally, given that there are obviously winners and losers depending on how the cards fall.

Just a comment in relation to the City of Sydney: yes, I appreciate probably the City of Sydney does throw up complexities, but I think if we are looking at this in the long run, there are other parts of Sydney, and perhaps the rest of New South Wales, that are also throwing up different degrees of complexity. I imagine the Macquarie Park area, if it has not happened yet, will probably throw up degrees of complexity, as will secondary cities like Parramatta, and so on.

I do not know whether there is enough rationale for separating Sydney out on the basis of complexity when there will be, or already are, pockets of significant complexity in other parts of Sydney and perhaps the rest of the state. Thank you.

MR BUTCHER: As Shaun has said, there are winners and losers with any reform, and, as he also pointed out, it depends on how the cards fall. Some councils will be more supportive than others of moving to a different methodology.

We have certainly recommended, in the first instance, to simply divide the total revenue estimate that we could get from the Valuer General's report, and the Valuer General kindly supplied some more information to us, to maybe even consider another alternative method - that is, separating the fixed costs of the Valuer General, which would form a base charge for all New South Wales councils, with the residual made up from an overall charge based on the number of valuations which would capture the larger cities, obviously with the more land valuations, and fix the amount across. However, I was not able to get the right information to be able to firmly determine what that would be. It may be something that the Valuer General could look into.

I again acknowledge that there is no change in the revenue. It will still be the same amount; it is just how it is collected.

The current system has a lot of faults in it, in that councils are able to determine and make a determination on what is residential and what is non-residential land. In our submission, we gave an example of how that is quite a cumbersome process and how disconnected it is to reality. We would support a change from the current methodology.

I think that is all I have to say. Thank you.

MS FLYNN: The City of Sydney would not be opposed to having one price versus two for residential and non-residential. That being the recommendation of the Valuer General, they must not see a huge difference in those two as being a factor in price.

The City of Sydney however, does not think that the four regions - certainly the regions outlined - are appropriate, and we do not think that the Valuer General has yet made a sufficient case. With only 40 per cent of the costs being geographically based, which is less than half of the cost, that is not the best indicator, in our opinion.

Also, clearly the City of Sydney has been isolated. There has not been a lot of information or supporting information as to why we would be different from Parramatta or North Sydney. There are a lot of councils that are similar to the City of Sydney that have not been singled out.

It is yet to be explained why the pricing structure proposed shows that Sydney would actually need to be double the cost of the surrounding councils. One of the comments was again about the annual verification checks that are done in the city that have pushed up its contract prices. This is not something that local government has requested or required.

The statement has been made that there is high risk in the city with regard to contract terms; however, this high risk is not to the council. There would be a large number of sales. There is a high turnover, higher than other areas in the rest of the city, so there ought to be a good data set for the valuers to obtaining information. We think that would make it easier to value those properties.

We would definitely like some more information on what the high-risk properties are, what is the volume, and why are they so different from other local government areas? I don't think that has been properly or adequately explained to date.

If there are annual valuations and higher costs attributed to that, is that something that needs to be borne by other users of valuations rather than the City of Sydney or local government itself?

With regard to the contract areas, in terms of the four regional areas that have been depicted and the fact that they are based on the contract areas that the Valuer General has, the City of Sydney stands alone in its contract area. It is therefore not afforded the economies of scale that every other council around it is afforded, and that is purely a choice of the Valuer General. We have had no input into that.

Similarly, with the regional councils, there are a lot of inconsistencies in this current method. There are regional cities which are not particularly happy with the structure. I believe one submission mentioned that, across the border, the valuation was far lower; the price, the values, were far lower than their own. As to why there would be such huge inconsistencies, we are not sure.

Ultimately, the case has not been made for these region-based structures. We would definitely prefer, as Andrew has mentioned, a much more transparent pricing structure of one price for all councils. We are essentially receiving the same service. We require the same values to rate our land, and the proposed increase of nearly $1 million to the City of Sydney has not been justified. Thank you.

THE CHAIRMAN: Thank you, Suzi. Are there any other comments from around the table?

MR WILLETT: I have one.

THE CHAIRMAN: Yes, Ed.

MR WILLETT: Michael, 41 per cent of costs are sensitive to geographic location. Do I take it from that that 59 per cent of costs are common to all services?

MR PARKER: The 41.3 per cent is based on the mass valuation objection costs, which we are able to define quite easily to a region. The other costs generally would be not unique. They would be across all the different areas. Certain areas create costs at certain times due to differences in requirements for subdivisions or amalgamations and things like that - but, generally, yes.

MR WILLETT: Thank you.

THE CHAIRMAN: Are there any questions or comments from the floor?

MR CARTER: Bill Carter, chief financial officer for the City of Sydney.

I would like to understand why, if the main driver for such a significant price differentiation reflects objections over the past history, you would be using such a model to go forward for six years. Demographics change. The nature of all councils is changing. Obviously there is a lot more density through all council areas. Therefore, it seems to be an inappropriate base.

THE CHAIRMAN: Michael, would you like to respond?

MR PARKER: Yes, thank you.

Firstly, on the results of the analysis we did, we thought over 10 years that that was the best set of data we had available. Again we don't know what we don't know. We can't predict where objection numbers will occur. That is quite a fluid situation and it depend on what is happening in that area. One year rural could be a significant contributor to objections; the next year it could be density property; the year after that it could be residential.

Generally it is more residential but there are certainly fluxes in the numbers. Using data that we have available is still, to me, the best way to understand what those cost drivers are.

If I could just go to Suzi and the City of Sydney and point out a few of the reasons why we have isolated the City of Sydney. It has its own contract area, and always has had its own contract area. It is consistently the most expensive contract in the state.

If we look at the numbers for the City of Sydney - and these are published figures, so I can talk about them; they are to do with the 2018 valuation year - for the City of Sydney, with 28,000 properties, the contract price was $626,000. North Sydney, or the North Harbour district which includes Lane Cove, Mosman and North Sydney, which had 25,000 entries, was $302,000.

Every year we consistently see that the City of Sydney is more expensive to value. We know there are complexities with the properties in the City of Sydney. For instance, the value of non-residential property in the City of Sydney is $38 billion as opposed to North Sydney which is $2.4 and Parramatta is $7.3.

There are other aspects of the City of Sydney which cause some complexity. For instance, there are 4,633 heritage properties in the City of Sydney, as opposed to 1,000 in North Sydney and 1,100 in Parramatta.

We know there is complexity in the town planning. The City of Sydney accounts for over 21 per cent of the state's gross product, so it is a hugely complex area of valuation. The contractor has to spend a lot more time in analysing the evidence in developing the valuations, especially as there is very little consistency in the streetscape. Just about every property is unique. That is why we have a number of high-risk properties, as you were alluding to, that require verification.

Verification was introduced after the Ombudsman's report. There we have accorded with a government recommendation to verify the land values, and we think it is important for the quality of valuations across the state.

If we look at the four regions, I guess it is our best way of putting the evidence, where we can actually say, "This is region-driven into the basket for those four regions".

There are lots of different ways you could distribute the Valuer General's efficient costs, but we thought that was the fairest and most equitable process based on the best available data that we had. Thank you.

THE CHAIRMAN: Thank you. Are there any other questions from the floor? Yes?

SARAH BOWE: Sarah Bowe, from the Hills Shire Council. I wish to say that, in principle, we are in favour of differential pricing for the region, in principle, as in one price for each region.

We also favour differential pricing taking into account that maybe metro should pay more than country, and the City of Sydney should pay more than metro. The thing that we are concerned about is that metro is subsidising the City of Sydney. We don't mind, as a metro council, subsidising rural but we don't want metropolitan councils subsidising the City of Sydney.

With regard to the figures that you gave, you said there were 28,000 valuations at the cost of $12.71, or whatever that is. This is $356,000 that the Valuer General is going to regain from the City of Sydney, but you said that the cost of the contract was $626,000. Is it that metro has been subsidising the rest of that?

In addition, the City of Sydney does have complex valuations. No-one else has an Opera House. They have a relatively low number of valuations with a high number of assessments. So when spreading the cost of that over their assessment base, it reduces that. That is all. Thank you.

THE CHAIRMAN: Would you care to respond, Michael?

MR PARKER: I am not sure about the maths. Those contracts prices I read out were annualised prices. The costing system that we are working on at the current time does not allow for the differential between City of Sydney and metropolitan areas and that is one of the reasons we moved to the regional basis.

We accept that, in certain circumstances, councils are subsidising other councils. That is why we have proposed the methodology we have. We know that rural areas are more expensive, and that is mostly do with travel to actually make the valuations. We know that the City of Sydney is more expensive, and that is to do with the complexity of those valuations. With regard to the coastal region, there is a little bit of winners and losers, depending on the make-up of those areas.

The points you are raising are exactly why we have adopted the approach we have, which is to try and at least diminish some of the cross-subsidisation between the different areas.

MS BOWE: But our point is that we don't mind the metro councils subsidising the country areas, we just don't want to subsidise the City of Sydney or any of the larger areas.

MR PARKER: Very generous, but we are trying to develop the best system to give a fair approach to everyone.

THE CHAIRMAN: We have a question from the tribunal.

MS COPE: You mentioned the value of non-residential land and drew the comparison that there was much higher value in the City of Sydney, when you were talking about reasons why the valuations were expensive. What is it about the value of the property that influences the complexity of the valuation process?

MR PARKER: With those sums I gave you, the value of a property is a proxy for complexity. Generally it is harder to value properties that are worth a lot more. We know that valuing a 30-storey building in the CBD, or the land underneath the 30-storey building in the CBD, is much more difficult than valuing a parcel of land out at Blacktown.

The process the valuers go through in developing the valuations is much more complex. The requirements to analyse the evidence are much more complex and they can't use the mass valuation process like they can in, say, a residential area in Blacktown.

The mass valuation process is basically the selection of a benchmark property, the valuation of that property, and the outcome from that valuation then can move many thousands of properties. If you have a very homogeneous area, the component can be 5,000 or 6,000 properties, you do one valuation and you can move 5,000. In the City of Sydney, or a complex area, that is not possible. You have to do a valuation almost singly on those properties. It is those techniques and that methodology which actually lead to the differences in pricing.

MS COPE: I understand that. It was more the specific issue of how the value of the property itself affects the complexity of the valuation. I am taking from what you are saying that it has something to do with the difficulty of determining the underlying land value if you have a high-value construction on top; is that what you are saying?

MR PARKER: Yes. I am only using those figures as a proxy for complexity. It is not a direct line. But it does demonstrate that there is more difficulty in valuing those properties.

MS COPE: Thank you.

THE CHAIRMAN: Matt?

MR EDGERTON: I have another question for Michael. Your proposed regional prices are based on your 18 contract areas. Could you tell us how you have basically determined the 18 contract areas. For example, you have split out the City of Sydney; why not split out other areas such as Parramatta or Chatswood?

MR PARKER: The prices we provided are not based on the new structure, they are based on the old structure, which is 41 contract areas.

I will get Dennis to answer the second part of the question.

MR SZABO: In terms of landing on the 18 contract areas, and a reduction from 41, currently Valuation Services, on behalf of the Valuer General, prepares 14 regional reports and has historically prepared 14 regional reports. Those regional reports pretty closely align to the current 18 contract areas.

The key changes are that the three regional reports in Sydney have been split into six contract areas, and the Hunter region, which is one region that we report on, has been split into Hunter and Hunter Coast. That is how we get from 14 essentially to 18 contract areas. These are naturally aggregated areas that represent similar attributes across the state. Consequently, through discussions with the Valuer General, we have landed on the 18.

MR EDGERTON: So it is basically your assessment of appropriate groupings reflecting estimates of differences in cost of valuation?

MR SZABO: No, these are natural groupings in the state - so the Riverina, the Murray, the Northern Tablelands, et cetera. These are regions that, I guess from a valuation perspective, we have been reporting on through our regional summaries or annual value summaries, so the contract areas more or less reflect those regional summaries.

MR EDGERTON: And what about the question for metro Sydney? You have obviously highlighted or picked out the City of Sydney. Did you consider other areas as well? .

MR SZABO: It is important to understand that the City of Sydney has been its own contract area for over 20 years. As Michael has described, the City of Sydney has a unique set of attributes around complexity, value and contribution to gross domestic product for the state. It is an outlier for good reason. It is a significant economic centre. As a result of us having quite strong evidence around mass valuation pricing and the volume of objections, we are suggesting that the City of Sydney sit alone in actual pricing.

MR MADDEN: Because it is an important distinction, I want to follow up on Matt's question. Would it be Chatswood or Parramatta that may be a candidate to being something that is complex similar to Sydney or is everything else, from your perspective, just in another pot?

MR PARKER: As Dennis was saying, we always have had the individual price for the City of Sydney. It has always been a single contract, and it has always been the most expensive on a dollar per property basis. Wherever we put the City of Sydney, it will be more expensive in that location. If you look at Parramatta - and again back to the 2018 figures - there are 83,300 properties in Parramatta, but the total price was $302,000.

The market is continually telling us that the City of Sydney is more difficult, more complex and more expensive to deliver valuation services, and we have a long history of data to support that.

MR MADDEN: I understand that. I guess the question is what is the threshold or where do you actually move to a different price? I assume in the contract you could ask for a price for the Parramatta city valuations, and then surrounds, when you are building a price for getting a mass valuation contract. I guess you are trying to get to those fundamentals, that you think Parramatta is a long way, if that is the best second candidate, and it is your knowledge, not mine.

MR SZABO: I might take that question, if that's okay, Michael.

MR PARKER: Yes.

MR SZABO: Let us look at some statistics around the comparison of the City of Sydney versus North Sydney versus Parramatta. In terms of the number of residential properties in the City of Sydney, it is 86 per cent of the total number of entries. In North Sydney it is 92 per cent, in Parramatta it is 93 per cent. On the face of it, you could say the City of Sydney and those other two centres are mostly residential. But in terms of the percentage that actually translates in value to residential, the City of Sydney is 60 per cent, North Sydney is 91 per cent and Parramatta is 87 per cent. The entries and the values seem to correspond, except for the City of Sydney, where you have a good proportion of them non-residential values and those sort of complexities that come along with non-residential valuations.

In terms of contribution to the state's gross state product, for those three centres, the City of Sydney is 22 per cent, North Sydney is 3 per cent and Parramatta is 5 per cent. In order of magnitude, the other centres are quite small, relatively speaking.

MR MADDEN: I wish to move on to a wider subject and away from that. Just to provide some comment on the removal of the residential versus non-residential, I think it was 2.2 that we had as the difference in costs, the multiplier. You are obviously moving away from that. Could you comment on whether there is - it may be hard to estimate - a persistent difference in the cost base or do you think that that cost base is not worthy of trying to estimate? I am imagining a regional centre versus a very basic smaller town with a lot less non-res properties and their potential concern about cross-subsidisation in the more non-res towns - such as Orange versus Molong or something like that. I am wondering why you have moved away from that. Is it something that is just difficult to estimate or does it have admin-type problems? I am wondering what the driver is.

MR PARKER: We accept that there are differences between the non-residential and the residential. As I said, with the residential, it is much easier to use those mass valuation processes and less individual attention is required.

I think the 2.2 was developed through previous hearings. We were not clear on how the 2.2 could be justified, so it was difficult for us to say, "Well, you know, that is the right way to go", other than that it was used before.

We accept that it is more expensive to do the non-residential, but putting an actual ratio on it, whether that is 1.8 or 2.2 or 2.7, is very difficult to do and we certainly do not have the data to break up that difference. The contracts are for whole areas, so we have never actually had specific data on the difference between developing a residential valuation as opposed to a non-residential valuation.

THE CHAIRMAN: Thank you. Yes, Shaun?

MR McBRIDE: With regard to the differential between the residential and non-residential, hasn't that itself partly compensated for the cross-subsidies? Isn't Sydney paying more because it has a higher proportion of non-residential properties? Isn't that sort of built in to that price differential?

MR PARKER: We have not done an analysis to that degree, but I would suspect that the flat rate would not compensate significantly enough for that variation. There was, and has been, cross-subsidisation across the state pretty much however you want to look at it.

MR McBRIDE: We are not advocating a flat rate at this stage, and we have previously accepted the argument that there is a difference in complexity between res and non-res. We have accepted that argument, which was reinforced at the last determination.

THE CHAIRMAN: Are there any further questions or comments?

MR EDGERTON: Following on from the question from Shaun, just to confirm, I guess we are in a situation at the moment where we have res and non-res pricing, but a common price across the state, recognising that non-res incurs great costs, but there is uncertainty in terms of by how much.

You are now looking at moving to geographic or regional-based pricing, recognising that any time you are drawing a line on the map, there is also an element of uncertainty there and that nothing is perfect. If you are saying that both geography and region as well as res or non-res are both cost drivers, do you have a view on what is the stronger cost driver? Is it the res/non-res split, or is it by location?

MR PARKER: The beauty of what we have done is we have developed on the evidence, so these are market tested. The regions tell us what is more expensive and not more expensive to value rather than us trying to arbitrarily decide. We have let the market determine what are actually the more expensive areas. I think that is the safer way to look at it.

Just coming up with a number of what that extra complexity adds and not having it based on any data or actual evidence is, I think, difficult for public servants to promote.

MR EDGERTON: Thank you.

MR SZABO: Can I suggest we go to the graph on page 80 of the submission, which I think is in your presentation, Kumi. That may give us a better visual feel for the volume of properties being valued in country, metro, Sydney and coastal areas, and, I guess, the total pricing based on the build-up from mass valuation, adding objection and then adding the general fixed overhead into that pricing, as Andrew had suggested.

We have done that and you can see that there are quite strong correlations between country volumes in the various subregions and the pricing is pretty consistent. It is the same with metro, Sydney and also with the coastal regions. I guess I would just like people to have a look at that.

MR WILLETT: Yes, I have been looking at that most of the time during these presentations. Without having done any statistical analysis, the thing that strikes me about that graph is that you could almost say there is as much variability within the regions that you have identified as there is between the regions.

That raises a question in my mind about where the real cost drivers for the variation are. I suspect, since there is no data that we have reflecting the difference between res and non-res that is actually driving the variation, but we don't know and that is the difficulty that I have.

THE CHAIRMAN: If there are no further questions, we have come to the end of the public hearing. On behalf of IPART, I would like to thank you all very much for participating in the hearing today.

MS BOWE: Excuse me, could I ask one more question?

THE CHAIRMAN: Indeed.

MS BOWE: It is not in relation to the things we have spoken about, but it is in relation to the additional comments, as well as the questions that went through.

We have one question in relation to our submission on the other comments, which relates to the effects of the Australian Accounting Standard 116. Australian Accounting Standard 116 requires councils to complete market price asset valuations every three to five years, and councils do that. It is very time consuming and costly. But the Audit Office now wants councils to do desktop valuations in between each year of an actual valuation. These desktop valuations have to use appropriate indices, but the Audit Office gives no examples of what are the appropriate indices.

The Hills Shire Council is asking the Valuer General of NSW to provide indices to allow councils to do desktop valuations on the operational land and community buildings. We are of the opinion that, with all the data you collect, you should be able to provide such indices.

I know Victoria already uses improved land value for valuing their properties, but they do provide indices to provide cost indexation factors for government departments, for financial planning reporting purposes only.

MR PARKER: Would you like an answer on that?

MS BOWE: Yes.

MR PARKER: That is well outside any legislative remit that the Valuer General currently has. If government was to require that, it would take legislative change.
I suggest you talk to the government of New South Wales and the Office of Local Government. I would be quite happy to talk to you about that, but at the moment it is certainly not within our brief to deliver that sort of data.

MS BOWE: Is it possible for you to do that even if it is not within your brief?

MR PARKER: I would be reluctant at the moment. That is not part of my remit as the Valuer General. Asset valuations are a matter for yourself. That is a service that could be provided in the private sector without engaging with the Valuer General.

MS BOWE: The Hills Shire Council has just confirmed that these figures are provided by the Valuer General in Victoria, but the Valuer General in New South Wales is not giving us anything.

MR PARKER: I am not familiar with the process Victoria goes through or why they would provide it and on what basis. As I said, I am happy to talk to you in a different forum about that.

MS BOWE: Okay.

THE CHAIRMAN: Thank you for raising that issue. I think, at this point, we will close the hearing.

CLOSING REMARKS

THE CHAIRMAN: I thank everybody for attending and expressing your views, where that has been the case. It has certainly been of great benefit to the secretariat and the tribunal to hear those views.

As I said at the start of the hearing, a transcript of today's proceedings will be available on the website in the next few days.

We plan to release a draft report and draft determination in early April, with about three weeks for comments for further submissions, and a final report and determination to be released in late May.

Finally, I encourage you to keep an eye on IPART's website for updates and further information on our timetable including the release date for the draft report and the due date for submissions to that draft report.

Thank you.

AT 12.25PM, THE TRIBUNAL ADJOURNED ACCORDINGLY