INDEPENDENT PRICING AND REGULATORY TRIBUNAL

REVIEW OF PRICES FOR LAND VALUATION SERVICES PROVIDED BY THE VALUER-GENERAL TO COUNCILS

Tribunal Members

Dr Peter Boxall, Chairman
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At

IPART Offices, level 8, 1 Market Street, Sydney

On Tuesday, 25 February 2014, at 9.30am

THE CHAIRMAN: Good morning and welcome and thank you all for coming. My name is Peter Boxall and I am the chairman of the tribunal and I'm joined by my colleague, Paul Paterson, who is also a tribunal member.

In particular, I would like to welcome you to this public hearing being conducted by the Independent Pricing and Regulatory Tribunal into prices for land valuation services provided by the Valuer-General to councils.

This review has been referred to us by the New South Wales Government. We are conducting this price determination under section 12 of our Act. IPART last conducted a review of the Valuer-General's prices during 2008. The current pricing determination covers the period from 1 July 2009 to 30 June 2014.

In this review, we will determine maximum prices to apply from 1 July 2014 for the Valuer-General's land valuation services to councils. The tribunal has not yet decided on the length of the determination period and we are open to suggestions in this regard.

As part of this review we released an issues paper on 10 January 2014, which sets out key aspects of the review process. Our issues paper outlines some of the matters we consider important to this review, our general approach to price setting, matters we must take into account under our Act when conducting a review and a draft timetable.

In the issues paper we have called for submissions from the Valuer-General, customers and other stakeholders. The tribunal is appreciative of those who have taken the time and made a submission to the review. Some of those stakeholders are participants in our round table today. All of the submissions we have received will be carefully considered in developing our findings and recommendations.

In accordance with our terms of reference, our approach to review involves establishing the services provided by the Valuer-General, establishing the efficient costs of providing those services, allocating the costs of operations to the user groups and setting maximum prices for the valuation services provided to councils.

This hearing provides an opportunity for the tribunal to hear views from the Valuer-General, customers and other

stakeholders, and to question the proposals put forward. In addition to the views expressed in written submissions, we will consider the views you provide today in making our decisions on the Valuer-General's prices.

The Valuer-General's submission and other stakeholder submissions are available to the public through our website. The proceedings today are being transcribed and the transcript will also be available on our website in the next few days. I ask everyone today to please state their name and organisation before speaking and to speak clearly for the benefit of our transcriber.

Following this public hearing we will release a draft determination and report for public comment in early April 2014. Stakeholders will then have about three weeks to make further written submissions for consideration by the tribunal before we make our final decisions.

We are scheduled to provide our final determination and report to the Premier by 31 May 2014, for maximum prices to apply from 1 July 2014.

Before we commence proceedings today, I would like to say a few words about the process for this hearing. The agenda for today's hearing indicates the order of presentations and the issues that will be discussed by the round table participants.

At the beginning of each discussion session, IPART will make a short introductory presentation outlining the issues for which we seek stakeholder input. Participants will then be invited to discuss and provide their views on these issues.

Assisting the tribunal today are IPART Secretariat members Hugo Hamstorf, CEO; Matthew Edgerton; Jean-Marc Kutschukian; and Veronika Henkel. We commence today with a presentation from IPART's Veronika Henkel and then a presentation from the Valuer-General.

Thank you, Veronika.

MS HENKEL: The review we are conducting is a review of prices for land valuation services provided by the Valuer-General to councils. So what has IPART been asked to do? In accordance with our terms of reference, our review involves establishing, not setting, the services provided by the Valuer-General to its customers; establishing the efficient costs of providing those services; allocating the costs to various user groups, in particular the councils; and setting maximum prices for the valuation services provided to councils.

What is our role? Our role is to determine the prices charged for a specific portion of the services performed by the Valuer-General - these are the land valuations to councils for rating purposes. The Valuer-General's other land valuation functions are outside of the scope of this review. However, in determining the Valuer-General's prices for services to councils, we will assess the Valuer-General's total revenue requirement for providing land valuation services for both rating and taxing purposes.

So the questions we ask are: have the land valuation services provided by the Valuer-General changed since the 2009 determination? And is the quality of services provided meeting customers' expectations?

Before we begin, we will look at the key developments since the 2009 determination. The parliamentary committee on the Office of the Valuer-General completed its inquiry into the land valuation system in January 2013. The committee's main recommendations included a new governance framework, a rules-based approach to valuations, improving valuation integrity and a fair and engaging process. Any major governance and/or procedural recommendations, if supported and implemented during the determination period, could impact on the costs for land valuations.

So our questions are: has there been any change to the land valuation process and does this impact the cost of undertaking valuations? Should we set a five-year determination or multiple determinations over the five-year determination period? And in what circumstances should IPART consider making a new determination?

The revenue requirement. We determine the revenue requirement for the Valuer-General's valuation services for ratings and taxation purposes. This reflects our assessment of the Valuer-General's building block costs. We then allocate a proportion to councils.

Our building block is made up of an allowance for operating expenditure, for taxation, return on and of assets, and working capital. Once we establish the revenue requirement for the Valuer-General, we then allocate the proportion to councils and come to the revenue requirement for the Valuer-General's services to councils.

The biggest component is the operating cost building block where, in the 2009 review, operating expenditure represented about 93 per cent of the revenue requirement.

The components of the operating expenditure are: the direct costs of the Valuer-General's office; direct costs of LPI providing general valuation services; and allocated joint costs from LPI.

So our questions are: what is the efficient operating expenditure over the referral period? What are the main drivers or determinants of the Valuer-General's efficient costs of providing those services? What is the scope of the Valuer-General to achieve efficiency gains over the period? Does the tendering process for general valuations lead to efficient costs? And how should costs be allocated from LPI to the Valuer-General?

Other components of the building block. In the 2009 determination, the operating expenditure made up 93 per cent of the revenue requirement. The remaining 7 per cent is made up of allowances for return on assets, depreciation, tax allowance and working capital.

So how do we calculate a return on assets? The return on assets is calculated by applying the WACC to the RAB. Only prudent and efficient capital expenditure is included in the RAB. In the 2009 determination, the allowed capital expenditure was $2.3 million per annum. Since 2009 we have changed our methodology for calculating the WACC. We now apply a real post-tax WACC and we determine the WACC by taking the midpoint of two WACC estimates which are derived from current market data and long-term averages.

So the questions we are asking are: what is the prudent and efficient level of capital expenditure of providing general valuation services over the determination period? And what is the appropriate rate of return for the Valuer-General's assets?

The final step in determining the required revenue is to allocate costs to councils. In the 2009 determination we allocated 40 per cent of the total revenue requirement to councils. The 40 per cent allocation was based on the proportion of total valuations received by councils annually; adjustments for economies of scale in valuations for OSR; the cost of printing, graphic and postage was also fully allocated to councils; and 50 per cent of costs of processing objections.

So is there a case for changing the methodology for allocating costs to councils, and, if so, on what basis should costs be allocated?

Finally, pricing. Our pricing framework. Our terms of reference require us to develop an efficient, effective and transparent pricing framework; to ensure full recovery of the Valuer-General's efficient costs of providing services over the relevant determination period; and to ensure that prices efficiently allocate the costs of the services between councils in accordance with relevant economic and pricing principles.

Current prices. In the 2009 determination, prices to councils were set to recover 36.9 per cent of the Valuer-General's total revenue requirement. We allocated 40 per cent. A 2:1 relativity was set between residential and non-residential prices to acknowledge the higher costs involved in non-residential valuations; and we decided on no differential prices for councils.

Going forward, how should the price path account for customer impacts? Should the current price structure of residential and non-residential prices be retained? Is there new evidence that would warrant differential pricing for councils? And, going forward, should an indexation approach be used to set prices?

That concludes my presentation.

THE CHAIRMAN: Thank you very much, Veronika. Phillip?

MR WESTERN: My name's Phillip Western. I'm the New South Wales Valuer-General. We thought it was important to provide an overview of the process and the activities of the Valuer-General and Land and Property Information and to put that in perspective for you. Most of you will be aware

of how we operate, but, as it is the basis of this whole determination, it is important to go through that.

I just want to give an overview, for a start, and then I want to talk about the performance of the valuation system over the period, obviously looking at service efficiencies and also service quality, and then we want to talk about the important aspect, which is obviously the reference period, in terms of looking at what changes are likely to occur, what has changed since the previous determination, how the cost base has actually changed and what we are proposing in terms of a price path going forward.

I think the role of the Valuer-General, to most people, is pretty well known, but the primary function is obviously to maintain the Register of Land Values. The second principal activity is to actually make valuations of land as prescribed under the Act. The third aspect, and an important aspect, is the ability of landholders to be able to contest those valuations and ask, where appropriate, for a valuation review. That obviously enhances transparency. It also assists us in terms of improving the equality of the valuations that are actually made.

The other point is that we obviously enter into valuation contracts. As most people would be aware, the vast majority of our work is outsourced and, therefore, it is market-tested at that level.

In terms of the relationship between the Valuer-General and LPI, I have, between myself and the general manager of Land and Property Information, a service level agreement. This is a very comprehensive document, which contains key performance indicators. Associated with that is a regular reporting regime where we look at where LPI are in relationship to the various KPIs and activities that they are doing. It is obviously very, very closely monitored to ensure that they are meeting the requirements of our office.

LPI manages the bulk of services on behalf of the Valuer-General. So the Valuer-General operates in a governance mode; the operational activities of the valuation system are undertaken by LPI. So that involves those activities that we talked about before.

Out of the office of the Valuer-General we are charged, really, with ensuring the setting of standards and policies in respect to the valuation system. LPI interprets those policies and standards and puts them into an operational-type document to either use internally or put out to the contractors.

Those of you who have been involved in my presentations in the past will see that this is a reasonably familiar diagram. We have made some enhancements to it. It includes now the Land Valuation Advisory Group, which is a group of key stakeholders who have input into the valuation system. So it consists of the Property Council of Australia, Local Government NSW, the Real Estate Institute of New South Wales, the Office of State Revenue and, of course, local government. Very important.

In terms of local government, you will see that down the bottom in the centre is where local government and the major stakeholders sit. You can see the various relationships between all the entities. In particular, you will see that Land and Property Information have a key activity in ensuring that they act as a conduit between a number of various stakeholders, so very important in terms of the whole process.

In terms of the financial performance over the current determination period from 2009 through to the end of the financial year 2014, the cumulative actual operating costs for rating and taxing were within 1 per cent of the estimated cumulative efficient operating costs. Those efficient operating costs were decided by IPART. That, from our point of view, is a fantastic achievement, because during that time we have instigated a number of enhancements to the valuation system, including a risk assessment process which allows us to better target those properties which are more vulnerable in terms of market change or risk associated in terms of their outcomes. We have also put in place a management assurance framework so that we can actually identify and evaluate where the key risks in the valuation systems are and ensure that we can put in place processes to either alleviate them or mitigate the opportunity for those risks to eventuate.

During that time, assessment growth was slightly below what we had anticipated, and all of you will be very

familiar with the fact that we went through a global financial crisis, and that obviously had an impact in terms of the amount of development that was occurring around New South Wales, to the extent that some of our growth over that period was down at about 0.55 per cent over that period, but we are expecting that to move back up towards 1 per cent and, indeed, we are seeing that activity starting to occur already.

The 2012/13 actual operating costs were within 1 per cent of the estimated efficient operating costs as well.

The other important aspect that the tribunal will be looking at is our service efficiency. That's obviously very important in terms of looking at the efficient costs of working within the valuation system. As the chair pointed out, the joint standing committee had a land valuation inquiry which was instigated in January of last year, and a report of some 200 pages came out in May, with a number of recommendations associated with that.

One of the key things that came out of there, or one of the aspects they had a look at, was in actual fact whether or not the system was cost effective, and they noted in their report that the valuation system is currently extremely cost effective.

We also use a number of other markers to assist us in terms of seeing whether our costs or our efficiency in terms of providing the service are efficient. We have taken part a number of times with the International Property Tax Institute's survey of valuation jurisdictions around the world. The 2007 benchmarking study just prior to the current determination determined that the services provided by the Valuer-General here in New South Wales are a low-cost service. Among the jurisdictions that were looked at in that survey included all of Australasia, the US, Canada, Great Britain and South Africa. So it was a wide spectrum of systems that were looked at.

A similar survey was undertaken in 2010, and in that survey, one of the notable things that came out was that compared with other jurisdictions, our average cost of providing valuations is only about 78 per cent of the average cost of other jurisdictions. So once again it is indicating that it is a low-cost valuation service, and what I would say in context is it is actually providing, excuse the pun, value for money in that respect.

The other important aspect is to look at benchmarking our costs. Once again, that's a key indicator in assisting us to determine whether or not they are efficient. For the 2014/15 period it is estimated that 90 per cent of the costs will actually be market tested and comparable to benchmarks. Our costs back in the 2008 determination were determined as being efficient by IPART, and since that time, while there have been some new costs introduced - and we will talk about that later on - overall, that situation hasn't changed from where it was back when that determination was made.

The other important aspect is that nearly 50 per cent of our costs are actually market tested. We obviously have a monopoly service, so it is very important from that aspect to know that we have an equity situation in respect of where it should be in regard to the market.

A lot of our costs are also internal - graphic services, our IT, finance and HR services. Once again, they were benchmarked in 2008 and found to be efficient, and, indeed, the work that we have undertaken in terms of preparing our submission to IPART this time has indicated that they still remain efficient.

The other important aspect that I have noted is that these costs, over the current determination period, have actually fallen. So we have made some real efficiency gains there over the period and we are looking to try to continue those through to the new determination.

Also, as in most businesses, one of the major components of cost to the system is obviously labour, and certainly our high-level benchmarking indicates that our costs are efficient there compared with what the other average salaries are in the public sector. Indeed, from my own personal knowledge of the salaries and the labour costs associated with other jurisdictions, ours are very, very comparable when compared with them.

The other extremely important aspect, particularly for Local Government and Office of State Revenue, and indeed our landholders, is service quality. We monitor the service quality in regard to the valuations through

a number of mechanisms. One of the aspects that came out with the FT surveys that have been undertaken in the past is that they looked at the level of quality assurance that has applied to valuation systems over those jurisdictions that I talked about before, and what we have found through that is that in the New South Wales valuation system, approximately 15 per cent of the valuations each year have a very intense quality assurance process associated with them. That compares with the average in other jurisdictions of about 11 per cent. So we are actually above the industry average in that regard.

We also use a number of well-known international statistical indicators in regard to quality, and you would have seen a lot of those in the submission. So we are really trying to look at aspects of a system which are very important to our stakeholders and, once again, councils are integral to this in terms of the accuracy of the valuations, and, importantly from a rating and taxation point of view, to ensure that there is uniformity in valuations, so that the tax can be applied equitably across the taxpayers.

During the determination period, some of these key indicators have shown some great improvement. Our coefficient of determination which looks at the uniformity of land values compared with sales - back in 1999, 93 per cent of local government councils complied with that particular statistical indicator, and in 2013 we are up to 98 per cent actually complying. So it is getting very, very close to 100 per cent.

The mean value to price ratio, which is really looking at the relationship of land value to sales prices, over that period has increased from 92 per cent to 96 per cent. And the PRD, or the price-related differential, which is looking at the vertical uniformity of values in relationship to sale prices as far as high and low-value properties go, has gone from 84 per cent up to 95.4. So all the indicators are demonstrating to us that the level of quality of the valuations that we provide rates very, very well against internationally recognised indicators.

The other aspect that we can look at for the valuation quality is the level of change that occurs within the Register of Land Values. Every year we assess approximately 2.4 million valuations, and so when we go through the valuation review processes, where I said that landholders have the opportunity to contest their valuation, we have an extremely low rate of change. In the period from 2002 through to 2011, the land register total value changed by 0.11 per cent on average over that period as a result of objections and, indeed, over the last two years it has even decreased further to 0.09 per cent.

Comparing that with other jurisdictions, both overseas and Australian, we are well ahead of the target there. British Columbia, for example, who are a comparable organisation to us, have a target looking for the roll not to change by more than 0.37 of a per cent, and data that we have out of South Australia and Western Australia indicates that we are either at or below the levels of valuation change for those jurisdictions as well.

The other aspect which I think is pleasing in terms of service quality - and I noted in the submissions that a number of the attendees here today have provided - is that the level of service provided by the valuation system to councils is generally well accepted and the level of service has been rated either good or very good, which is, from my point of view, extremely pleasing, particularly in terms of where we were perhaps eight to 10 years ago in that level. So that has increased and it is a very pleasing aspect of the changes to the valuation system.

The other important aspect that Veronika talked about was in terms of the changes in the cost drivers. As I said before, most of the activity within the valuation system is undertaken by private contractors working for us. Over the last two years, we have had a reasonable increase in terms of contract costs for the tenders that have been made and accepted, and as I have noted there, it has gone up 11 per cent over the last two years.

There has been a number of principal drivers to that. One of the key ones there is that all valuation contractors have now inherited higher insurance costs. Those of you who are familiar with the property sector will know that the cost of obtaining professional indemnity insurance has gone up quite considerably over the last five to six years. Some of it is as a result of activity in terms of charges that have been brought against valuations or where, in the case of the global financial crisis, there has been a decrease in value as a result of market decline and banks

have been using valuers often as a lever in terms of trying to recoup costs. That has had a direct impact on the rating and taxation situation.

Having said that, to my knowledge there hasn't been a claim in terms of professional indemnity insurance against any rating and taxing contractor who has worked for the Valuer-General here in New South Wales.

The other aspect that I talked about very briefly before is that we have a vastly improved verification process where we are targeting specific properties, high-risk type properties. So we are really trying to there ensure that our activities are directed to those properties where there could be a substantive risk, either from a revenue point of view or, more particularly, in terms of where market data might be actually limited or might be vulnerable, in terms of market activity. So there is a lot of work that has been undertaken there.

The other aspect that we have seen slight increases in is that the costs of servicing more regionally based contracts, as opposed to metro contracts, has always been slightly higher, but we have seen some additional costs coming through there. For example, a lot of the property associated with regional contracts, or some of it, tends to be more specialist-type properties - for example mines and things like that - so there are actually more hours involved in assessing those properties, therefore, that comes in in terms of when the valuation contractors are applying for a tender. But there is also the tyranny of distance and the additional time associated with travel and those sorts of things.

So despite the fact that, as I said, the contract costs have increased 11 per cent over the last two years, we are still under what we indicated would be the cost of undertaking that work over the determination period.

The other area that Veronika pointed out before was in terms of the report from the joint standing committee. The government has agreed to 18 of those recommendations, which we are in the process of implementing now - and, once again, we will talk about that a little bit more shortly - nine others are due for further investigation and we are consulting with stakeholders, including the majority around this table today, particularly in terms of industry associations or representatives.

As I pointed out before, the other main cost driver is obviously the annual growth. We have built in a 1 per cent annual growth in the Register of Land Values.

In terms of the efficient costs forecast going forward, we have adopted effectively the same methodologies that we did in the 2008 submission to use going forward. In relative terms or real terms we are predicting that our operating costs, going forward, will be pretty stable over the coming years through to the end of this determination. Most of the costs, as I said, are below previous forecasts or are forecast to increase by just CPI over that period. That will include, obviously, key operating costs like HR, IT, our contract costs and the cost of graphic services in terms of publications and things like that.

In terms of the cost base changes over the period, we have a 5 per cent nominal increase in mass valuation contract costs over the 2013/2014 level. We are looking at an increase in labour costs in the 2014/2015 financial year due to five new positions coming in to LPI.

Like most organisations, we have had, over the last five to six years, a substantive number of retirements out of our staff within LPI in particular, and indeed the Office of the Valuer-General. There has also been undertaken over that time a number of reviews of LPI and government mandates in terms of resourcing levels, which has meant that we haven't been able to necessarily re-employ people or fill those positions. Also over the time we have had some changes in terms of more efficiencies being brought into the valuation system, which have allowed us to reduce the number of full-time equivalents operating within the valuation system over that period from 143 down to 120.

As I said, we are in the process at the moment of updating our skill levels and bringing more skills in, which will obviously also work in terms of ensuring that we have a plan going forward as more retirements actually occur.

The other important aspect is that we have cut the number of management positions within LPI and we have now reintegrated that by ensuring that we actually have more

people at an operational level. This, once again, is providing more efficiencies, which is important.

The other aspect that we have a large amount of detail on in our submissions is that this time we have also included the costs of spatial services, titling and imagery. Once again, those of you who are associated with property will know that integral to ensuring that we can undertake both valuation work and the assessment of property values in the most efficient way is to make full use of the available technology. Once again, this assists us in terms of being able to make more determinations in a more equitable fashion and ensuring the quality of the data.

Certainly over the last five years there has been a substantive increase in terms of what is available for us to be able to use and improve the valuation quality and the service that we provide. So these costs are included in this proposal as well. We have adopted, obviously, the IPART methodologies for return on capital.

In terms of the basis of the proposed prices, we have submitted that there should be a common pricing model for all councils, so we have said that we want to continue the methodology that was used for that from the current determination.

From our point of view, that certainly provides a more equitable approach. Also, it allows, from my point of view, councils to have more accuracy as far as budgeting going forward. We actually know what is going to be involved going forward and can make some reasonable predictions in terms of what price increases might be.

I also note from the submissions that were put into IPART that most of the submissions actually agree with that proposal in terms of how that is actually modelled.

So we want to stay with the current structure and relativity between residential and non-residential valuations. We still believe that's a fair reflection of the 2:1 ratio that was mentioned before. We are also advocating that the current split, which is 60 per cent of costs to OSR and 40 per cent to councils, should be maintained.

Veronika mentioned before that the current price path recovers about 36.9 per cent of efficient costs. As I said, we want that to be 40 per cent going forward to ensure that we can actually recover the efficient costs, and as I said, the other aspect that we want to ensure is that there is no spike in terms of the prices. So while we are indicating that in at least the first year there will be an initial increase in the costs which will accrue to the valuation system in terms of some changes that we are making, we are advocating or asking IPART, in terms of their determination, not to put all those prices in in the first year, but to have a smooth price pathway through to the end of the determination. So when we come to the end of this next period, we will be recovering the full 40 per cent of the cost, and we believe that's a reasonable way to go forward.

Most of you will have seen this slide. I won't go into it in any detail. This is what we are proposing in terms of the prices. So overall we are looking at, on average, a 5.3 per cent increase in prices. However, 2.5 per cent of that has been allocated to inflation. So in real terms, there is a 2.8 per cent increase per annum in valuation services' prices going forward.

You will have once again seen this slide on efficient costs and price path in the submission. We have put it into graphical form. The black line at the top is just showing if you recovered the costs straightaway and did it every year, what it would be, and then the other lines are actually showing if you actually have a smooth price path, and that is indicated further down in terms of the yellow line.

That concludes my presentation.

THE CHAIRMAN: Thank you very much, Phillip. Do you want to say something now, Simon?

MR GILKES: No, I think that has covered our introduction. I am sure there will be some chances to provide more detail, as we go.

THE CHAIRMAN: Sure. Thank you. So the next part of the agenda is questions of clarification to IPART or to the Valuer-General or to, I guess, LPI as well.

Then, afterwards, we have structured discussion on a number of topics from 6 to 10 on the agenda. So I would ask, to the extent possible, if you could just limit questions for this period to questions of clarification on the presentations, just to make sure that we understand what is going on.

In that vein, maybe I could ask a question of clarification. On the spatial services, titling and imagery, you are proposing that the costs for that be allocated in this determination. What happened to the costs of those in the last determination?

MR GILKES: When we prepared the submission for the last determination, we didn't have as good systems for tracking those things internally. Whilst we had provided them commercially to outside the organisation, the systems had originally been set up in such a way that whilst we might have known the total use by LPI, we weren't able to properly allocate it between various parts of the business and so we didn't capture that in the last submission. We now have much better recording systems around that and are able to be reasonably confident in the way that we have allocated those costs.

We believe that they are part of the fundamental infrastructure of running an efficient valuation system and so form part of the genuine costs of carrying out this form of business.

THE CHAIRMAN: Just in terms of the budget allocation, is money appropriated directly to LPI for the services that you provide to the Valuer-General or is it appropriated to the Valuer-General who then, in effect, purchases the services?

MR GILKES: The way it works is that legally the money goes to the Valuer-General. In practice, because LPI has the infrastructure to do so, LPI actually collects the money and the Office of the Valuer-General is funded through that, as well as the operations of LPI.

THE CHAIRMAN: Because it raised a question in terms of how this is being financed, because in the previous determination you under-recovered, according to our model. The determination had allocated 40 per cent to councils but only charged to recover 36.9. So what happened to the rest? Who ate the rest?

MR GILKES: LPI absorbed the rest. LPI is an off-budget agency, or non-budget-dependent government agency, I think is the correct term. So we receive no direct funds from government as such; it is all fee for service. To fund the gap, we had to find operating surpluses across the rest of the organisation.

THE CHAIRMAN: How did your other customers feel about that cross-subsidisation?

MR GILKES: I don't know that any of them raised any issue, we possibly didn't publicise it that much.

THE CHAIRMAN: Just one other question. On the FTEs you mentioned that you have gone down from 143 to 120, and then you are looking at an additional five at the moment, which would contribute to an increase in your costs. So the cost performance - which looks admirable, I might say - over the last five years, is that sustainable? Your good cost performance over the last five years, has that been, in part, due to the fact that you have run down from 143 to 120, and now you have realised that 120 is not enough?

MR GILKES: That's very much the case. Particularly in the last couple of years, there have been a few factors that have impacted. As Phillip mentioned in his talk, there has been a number of reviews of LPI going on, and the probably unintended consequence of that is that there has been effectively something of a staff freeze while things were up in the air. The age profile of our valuation staff is such that quite a number of people have retired over that time.

We have also been conscious, though, of the increase in contract costs, and part of the way that we have been able to manage that within the price cap we have been working to is to absorb staff losses. However, we are at the point where that's becoming unsustainable. We have almost reached the base level.

THE CHAIRMAN: Thank you very much, Simon. Other questions? Does anybody else have any questions of clarification from around the table?

MS RICE: Jacqui Rice, City of Sydney. The 1 per cent

growth - our figures for City of Sydney indicate that we are going to have a 14 per cent growth over the next 18 months to two years, yet you have put 1 per cent across the five years. Our indications are that the growth is obviously growing, and you have put 1 per cent across the five.

MR WESTERN: Just to comment on that, Jacqui, the 1 per cent is obviously right across New South Wales. And I'm presuming that the figures that you are quoting would include individual apartments, et cetera?

MS RICE: Yes, growth overall.

MR WESTERN: That would contribute to why there would be a difference, because under the Valuation of Land Act, the Valuer-General doesn't assess each individual apartment but, rather, the strata under the base of it. So you are right, there is obviously a substantive amount of growth in Sydney, but most of that would be in apartments, which we don't value individually.

MS RICE: But compared to past growth, it is increasing, not stabilising at this time, really.

MR GILKES: That's right. Over the period of the current determination, I think the average growth in the register, whilst we projected it at 1 per cent five years ago, has actually been 0.55 or 0.6 per cent, from memory. So you might ask the question why do we then now go back to projecting 1 per cent when that proved to be not the case. It's worth remembering that the last determination included much of the impact of the global financial crisis as well as a well-reported lack of land for release for residential development.

We believe that the market has strengthened and certainly the subdivision activity is strengthening, and we are seeing that through the volumes coming through our titling activities as well as valuations, so we believe that the growth across the State is likely to return to more like the long-term trend of around about 1 per cent.

MR McBRIDE: Just as a clarification, we are talking about the growth in the register of 1 per cent or 14 per cent in Sydney, and so on, but as charged on a per-unit or per-valuation basis, really, that's driving revenue and providing economies of scale rather than actually being a cost driver. Just a query.

MR GILKES: Yes, certainly it changes the revenue base. We recognise that. Though growth in the register does actually come at a cost, a labour cost as well, in that there is additional work to do to bring that to account.

Also, part of the issue in projecting this is that, yes, there is some risk that that estimate is not correct, and that is a risk that we carry in the projections, in that in working out the pricing to apply to achieve the overall revenue requirement, there is actually a risk that if the register doesn't grow at the rate of 1 per cent, it comes at, effectively, a cost.

THE CHAIRMAN: Thanks. I just have one other clarifying question on the common pricing model, which is the one that you put up on that slide: what is an uncommon pricing model? Is that where you might, for example, have a price for a residential valuation which would differ council by council or region by region?

MR WESTERN: Yes, there is a number of ways that you could look at that. For example, one of the aspects is that we hold, obviously, data in terms of the different categories of property, and as you will be aware, various properties require different levels of work in them. Some are more specialised than others - obviously in residential versus commercial, commercial is a lot more expensive to do. You could do it on that basis. That becomes a little bit more complicated as far as doing that. And we think that the non-residential versus the residential component we have there, the 2:1, accounts for most of that anyway, in terms of overs and unders, and when you actually end up looking at individual councils, other than the major metropolitan ones, it is a reasonable allocation of the cost of servicing.

Obviously Jacqui, with the City of Sydney - the cost of servicing that is a lot greater than the cost of servicing Tamworth or somewhere like that.

THE CHAIRMAN: The cost of servicing Sydney is greater than Tamworth because Sydney has more non-residential business?

MR WESTERN: Yes. There is obviously a lot more intensity in terms of undertaking the valuation work in Sydney.

So if you were to try to look to allocate the costs I guess more fairly across the state, then you would end up looking at the amount of involvement or amount of work involved in each local government area, and that would be reflective of the activity involved. But certainly our contracting cost, our contractors who put tenders in, tend to reflect proportionately that those costs for those local government areas where there are more specialist-type properties would tend to be higher than those where there is just limited activity, for example Blacktown or somewhere like that.

THE CHAIRMAN: I have to say, I am just coming to grips with some of this stuff. It seems to me that you can have price differentiation according to the property - like you could have non-residential, and, if you wanted to, you could split that into farming and mining and stuff like that; and you have residential, and if you wanted to, I guess, you could split that into strata or individual homes. But then you might have different costs for servicing different areas for the same property. In other words, valuing a standard house block in Tamworth might be different than valuing one in North Sydney - I don't know. But as I understand it, the common model has basically just said, well, let's take residential and non-residential and have charges for that. And I guess if one council has a higher proportion of non-residential than another council, then they would pay more?

MR WESTERN: Correct.

THE CHAIRMAN: Thank you for that. Simon?

MR GILKES: I think there is certainly the potential to build almost endless complexity into the pricing model. What I would say is that I think that the current model is reasonably equitable. The difference between residential and non-residential largely reflects the difference in effort required.

If you think broadly, there are a couple of different classes of the non-residential property. That includes commercial lands which, whilst concentrated, are complex to value. On the other side, it also includes rural properties, which, whilst probably relatively easier to value, suffer from the additional costs associated with distance and the like. So overall I would argue that it probably provides a reasonable base.

THE CHAIRMAN: I hasten to add, I am having no thoughts about making it more complex, but it is a legitimate point: it is an issue of a trade-off between simplicity in administration and ease of use with costs reflectivity.

Any other clarifying questions from the floor or around the table, before we move into the first item of structured discussion? Okay, thank you, let's move into item 6 on the agenda, "Service levels and length of determination period".

MS HENKEL: The first discussion is on service levels and the length of the determination period. Since the 2009 determination there have been several reports that were mentioned earlier and inquiries into the provision of land valuations: The DFS Review in 2012, the LPI Strategic Review in 2012/2013 and the Joint Standing Committee on the Office of Valuer-General. Some recommendations may impact on the Valuer-General's cost base during the determination period. The Valuer-General is proposing a five-year determination for the determination period, with an option to make a new determination for any significant changes to its operating model.

Some of the questions that we have are: Have the land valuation services provided changed since the 2009 determination? Is the quality of the services meeting customers' expectations? Has there been any change to the land valuation process? Does this impact the cost of undertaking valuations? Should we set a five-year determination or multiple determinations over the period? And in what circumstances should we consider making a new determination?

THE CHAIRMAN: Thank you very much, Veronika. We will leave that slide up. Just in terms of discussion on those points, would anybody around the table like to kick off the discussion?

MR GILKES: If I could pick up on the third point in particular, "Has there been any change to the land valuation process?", probably the major change in the land

valuation process over the current determination period has been, as Phillip touched on in his opening remarks, a change to the processes around quality assurance and value verification.

Following a review by the ombudsman in 2005, we implemented a rolling process of individually reviewing the land value of every property on the register over a five- or six-year period. At that point, it had been some years since that had occurred, and so that was initially implemented as an across-the-board approach to that value verification program, and essentially looked at 20 per cent of the properties on the register each year.

After we had been through that first round, we have refined that process to focus more heavily on those properties that present a risk to the value base. Those properties that are more complex are reviewed more frequently; those properties that are less complex - for example, the broad areas of single residential properties in large local government areas in Western Sydney - are individually reviewed on a less-frequent basis to try to better focus those efforts.

Through the tender process it is very difficult to be able to isolate particular impacts on prices. It is possible that the change in that emphasis in that program has had some impact on contract prices but, as I said, there is a number of things at play, so it is very difficult to isolate whether, in fact, that is a reason for a change in the cost.

THE CHAIRMAN: Thank you, Simon. Anybody else around the table? We would be particularly interested in hearing about the length of the determination. Obviously, one option is just five years. Another option is a shorter determination, which means we would need to have a process again, say, after two or three years, or we can always, I guess, re-open a determination, but it is a fairly big decision to re-open a determination. Any views on that or any other views on this topic?

MR WESTERN: If I might just have a quick comment there. As I pointed out in our initial presentation, we are of the view that over the next five years there is unlikely to be any significant change in our cost base. However, we have also pointed out in the submission that there are a number of risks associated with the valuation system going forward.

One of those risks potentially, and which would impact upon the need to potentially come back to IPART, with the Premier's approval, for a new price determination, would be the joint committee's recommendations. In particular, I would refer to if, for example, the Valuation Commission was to be implemented, that would come at some significant cost in terms of putting that in place. You will appreciate, in a business, in terms of going through the whole re-branding process, what is involved in that in setting up new structures and everything like that, so that would potentially impact.

The other unknown one at this stage - and I have discussed it with some stakeholders around this table in an initial consultation - is, for example, the three-year averaging, which the committee recommended should be for local government. Depending upon, if it was implemented, how that was structured, that could result in significant cost changes for the valuation system.

As an example, currently we issue a notice of valuation on average once every three years. There are some local government areas we issue it every four years. If they were to use a three-year average, there is a possibility that we would be required, because the value would be on the Register of Land Values, to issue that every year. If it was to be issued every year, there is the cost of actually putting that out there. Despite the changes we have made in terms of trying to put more electronic notices out there, there would still be a substantive cost just in postage and printing alone, in terms of putting that out. And then there is, as I said before, the right of landholders to be able to ask for a review of that valuation. So, once again, there would be potentially some increased costs as far as objections go as well.

So while we have pointed out clearly in our submission that we are looking, wherever possible, to actually absorb the costs of some recommendations - and, indeed, one of the ones we are looking at at the moment is a dispute resolution process between the end of the valuation review or objection process and going to court, putting something in place there that assists the majority of landholders in

New South Wales, those types of recommendations that we are implementing we are trying to absorb. But there could be some which will result in a substantive increase.

DR PATERSON: To the Valuer-General, when would you anticipate those recommendations might take effect, if they were to go forward?

MR WESTERN: As I said, we are going through a consultation process currently. My expectation is that we would conclude the majority of that consultation certainly by the end of April, beginning of June. As a result of that, we would need then to go back to government with our findings, and then government would need to make some decisions in terms of going forward, as to whether to implement those.

Potentially, I wouldn't expect, if there was to be any substantive change in the cost base - and Simon might want to comment on this - that it would occur until somewhere in 2015/2016.

MR GILKES: In terms of the consultation process, I don't think I can really add much there.

The other point, though, that I would make, is that I mentioned previously that because of a number of reviews of LPI we had held off filling vacant positions. One of those reviews was a strategic review of LPI to consider whether it should, in fact, be put to some sort of commercial operation model through a concession kind of arrangement. Because of a number of things going on in LPI and, in particular, work around the implementation of national electronic conveyancing in the titling area, the government decided to suspend those considerations, but has flagged that it may revisit those in the middle of 2015 or thereabouts. I don't have any way, though, of knowing what the view of that will be.

MR PHILLIPS: Ian Phillips from the Office of State Revenue. Just a question about the impact of some of those recommendations of the joint parliamentary committee, particularly three-year averaging for councils - what impact would that have on the allocation of costs as between OSR and councils, given that councils would be using the same average values that the OSR currently uses.

MR GILKES: The way that the current allocation - and I know that we will talk about this in more detail as we go - of 60:40 was worked out was through considering a range of the elements of the system, including how often valuations are issued to council versus OSR and how the balance between objections works, and a range of things.

Without actually working backwards through that whole process - and I haven't done that at this stage - I can't tell you exactly what impact we believe that would have. I guess the simple and obvious answer is that it would certainly shift the balance of costs more towards local government than currently.

THE CHAIRMAN: Thank you, Simon. Can I offer something and then people might or might not like to react to it.

In terms of the length of the determination period, it strikes me that this is a proposal where costs are relatively stable - the projected costs are relatively stable. The major uncertainty surrounds what is essentially a government policy decision to make a change. This is different than, for example, gas pricing, where the major uncertainty surrounds what is going to happen in the wholesale gas market.

So one model is to do the five-year determination period and then, if there is a relatively large policy change, the Premier could request us, obviously advised by you guys, to redo the determination, given the costs, and that would get to issues about the 60:40 allocation, the cost to councils, the whole lot, and we would go through a process not dissimilar to this again.

The alternative is to do a five-year determination and we just give indicative prices out in years two, three, four, five, and then we could update them in a relatively quick way. I don't think that's really suited to this process. I think the best shot is that we do the five-year determination and then, if there is a large change to policy, which basically would be, in a sense, a shock to the supply side costs, because of government policy, the Premier could request that we do another determination. I think the staff are nodding that that's okay.

What about the rest? Are people comfortable with that sort of approach - also from the floor?

MR GILKES: In LPI I have a dual role, I'm the deputy manager, which means I am responsible for the finances of the whole organisation, as well as being the director of valuation services. From my perspective, a five-year determination is greatly preferable because of the predictability that that brings; and I would imagine that many in local government would appreciate that same benefit.

DR PATERSON: The local government people?

MR McBRIDE: I think we would agree with that approach. If there was a policy change, it would have to be reassessed I think, as you said, through a like process to this but more narrowly defined. Because I think local government, for one, would object to paying for policy changes it doesn't support or additional services, like three-year averaging, that it hasn't sought. So there would be some in-principle objection to additional costs for something we didn't want and that is of very little advantage to us in a rate-pegging environment anyway. So, yes, it would warrant policy-by-policy consideration.

THE CHAIRMAN: No doubt during the government's consideration of whether they are going to adopt these proposals or not, local government and councils and others will have a chance to make their views known.

All right, anything else on item 6, which is essentially the questions up on the board? Nobody wants to add anything? Good.

Let's move to the next one, which is "Required Revenue Forecast for the 2014 Determination Period". Veronika.

MS HENKEL: The Valuer-General's forecast. For 2013/14, the revenue collected by the Valuer-General is forecast at $15.3 million from the councils. The Valuer-General is proposing about 18 per cent real increase in revenue required from 2013/14 to the first year of the next determination. Revenue required is projected to be constant thereafter.

The Valuer-General attributes the step increase to the catch-up to full cost recovery, which is about 50 per cent; the increase in cost of mass valuations; newly allocated costs for spatial services, title searches and plan images; and changes in the treatment of return on and of capital.

The biggest component of the revenue requirement is the operating expenditure. In 2009 we accepted the Valuer-General's total opex of about $34 million for the base year, which was 2007/2008. The opex represents about 93 per cent of the total revenue requirement. As the Valuer-General previously mentioned, operating expenditure over the current determination is in line with the base year that we accepted in the last determination.

Going forward, for 2014 the Valuer-General is proposing total operating expenditure of about $44 million in 2014/15 and to maintain it constant in real terms thereafter.

This represents about a 7 per cent real increase in the Valuer-General's total operating expenditure from the last year of this determination to the first year of the next. The Valuer-General states that this is due to increases in labour costs, mass valuation contract costs and costs allocated from LPI to the Valuer-General.

The questions we have are: what are the main determinants of the Valuer-General's costs? Does the tendering process for general valuations lead to efficient costs? How should costs be allocated from LPI to the Valuer-General? And what is the scope of the Valuer-General to achieve efficiency gains over the determination period?

THE CHAIRMAN: Thank you, Veronika. Questions or comments on this issue?

MR TODD: John Todd, CFO at the City of Ryde. I have a question in relation to the operating expenditure. Does that also include depreciation?

MS HENKEL: No.

MR MUSTAFA: Phillip Mustafa from Land and Property Information. I would just confirm that. No, it is not included.

THE CHAIRMAN: So where is depreciation?

MR TODD: That's one of the questions.

Another question I have is in relation to some of what I call the NCP costs - the income tax, land tax and all those taxes that aren't actually paid, which you are introducing in relation to the operating costs. They are costs that the VG won't pay, because they are same as councils, and we take them into consideration when determining our costs under NCP. What happens to the cash that you actually get physically paid in relation to those costs, since you don't have to pay them out?

THE CHAIRMAN: That's an issue about moving from the pre-tax to the post-tax WACC. Do you want to have a go at that, Jean-Marc?

And I still want to know what happens to depreciation, but we will get to that afterwards.

MR KUTSCHUKIAN: Jean-Marc Kutschukian, IPART Secretariat. Basically, our approach to the building block is that we reflect the efficient costs of a benchmark firm in a competitive market and basically follow principles of competitive neutrality. So that's the way that we regulate, and our terms of reference also ask us to set the efficient costs for the Valuer-General and that's our interpretation of efficient costs. So we have a tax block in the building block, plus a return on and of capital.

MR TODD: Just in relation to that, we at council also do the same thing when looking at our fees, and then we set a fee or charge. It doesn't necessarily depend on whether we recoup those costs. But we will do what is called a community service obligation. In other words, we may recoup only our direct costs, because we don't require the cash for tax or whatever. So when we want to benchmark, we include those costs; when we don't want to benchmark, when we only want to recoup, we don't include them, so, therefore, we have a community service obligation which is the differential. It is a requirement in Queensland to do the same thing and also report on those.

So my question is: why isn't that then a community service obligation, that the Valuer-General has to show rather than recouping it, because it is not real cost.

MR KUTSCHUKIAN: I think we would have to take that on notice.

THE CHAIRMAN: We used to use a pre-tax weighted average cost of capital. We now use a post-tax weighted average cost of capital. You are quite right, we take account of the tax that would be paid in order to work out how much something is going to cost.

You want to know what happens to that money, right? Because if councils are paying prices which are based on the full costs, which include payment of taxation, and because the government is exempt from taxation they are not paying that tax, what happens to that money? So why don't we ask Simon and the Valuer-General?

MR GILKES: I will take this one. I can give you a broad answer. If you want the very fine detail, I would have to take that on notice.

Essentially, the way that LPI operates as a non-budget-dependent government agency, we pay tax equivalent to Treasury and then whatever surplus is left over after tax, we pay a dividend.

THE CHAIRMAN: Based on my experience in government at the Commonwealth level, that's the answer: it is a tax equivalent payment which is paid from the organisation, in this case LPI, to Treasury. So, in that sense, it is fulfilling a community service - it goes back into the community.

MR McBRIDE: Just in principle, for the record, we oppose the application of that tax on the basis that this is not a contestable service. In a contestable market we can understand the application of competition policy principles, but in this environment, where we have no alternative - unlike in some of the other states, we have to use this service - we think the tax is unjustified, the tax inclusion.

THE CHAIRMAN: Okay. We don't think it is an issue about whether it is contestable or not. When IPART regulates an enterprise or an industry, many of which are monopolies, we try to regulate them and get their pricing, to the extent we possibly can, to what would replicate what would happen in a competitive market, and in a competitive market, enterprises have to pay tax, and that's one aspect.

The other aspect which Simon mentioned is the competitive neutrality principle, which was adopted quite a while ago, which is about the importance of government organisations - which goes to Sydney Water and all these other places - having to make tax equivalent payments so that they are put on the same basis as the private sector, even though there may not be a private sector organisation which happens to be competing with them.

Other questions or comments?

DR PATERSON: I have a question for the Valuer-General or the LPI. In the elements around the step increase, Veronika included increase in the cost of mass valuations. Could you explain that item, please?

MR GILKES: That refers to the increase we have seen in the cost of mass valuation contracts, which are the main contracts used to operate the valuation system. They are sourced through a competitive market process, but in the last couple of years particularly, as Phillip touched on in his opening remarks, we have seen a reasonable increase in the level of those prices - I think in nominal terms, 11 per cent over the last two years.

We expect to see a flow-on in the coming year, because they are three-year contracts plus option periods. The last two years have seen an increase. We expect that increase to be seen in the coming tender process, but then for the market to normalise again, and so we would anticipate beyond that point that the costs would increase basically by inflation.

THE CHAIRMAN: I would like to ask what happens with depreciation. I appreciate that this operation has a relatively small capital base, but, nevertheless, you do have some capital. Can somebody discuss that, please?

MR GILKES: It is probably me, unfortunately. I would hasten to add that I am far from being an expert on the treatment of depreciation.

Certainly in our submission the way that we have determined the cost of and cost on capital is using the IPART formulas and basically plugging in the particular set of variables. What actually happens to that? Well, we account for it in our accounts. As one of the costs of doing business we have to replace capital over a period of time and we have an ongoing program of doing that.

THE CHAIRMAN: I think this is an area we might check out a bit more.

MR TODD: One of the questions in relation to the return on and of capital, in relation to the assets: are only those assets that are used in the actual provision of valuation services included, or are there other assets that may be leased out or owned by LPI, where they already get a return on capital from some other area?

MR KUTSCHUKIAN: There are basically three asset classes in the RAB. So we have land and buildings which are owned by LPI, I believe; plant and equipment; and intangibles. Then we have an asset life allocated to each of those and then we weight the asset life and calculate the depreciation on that and the return of, on those assets, as well.

Some of them are owned by LPI. I don't think any rental property is included in the RAB, it is just assets that are owned, and they are allocated on an FTE basis, I believe, or occupancy rates there. It is the actual usage of the assets that go into the RAB, not the whole asset itself.

THE CHAIRMAN: Does this mean it is included in the cost base - depreciation?

MR KUTSCHUKIAN: Yes, it is.

MS HENKEL: Not in opex.

MR KUTSCHUKIAN: In the cost base, depreciation is.

THE CHAIRMAN: Sorry, scratch all that. As long as it is in there, yes.

MR TODD: The reason why I asked if depreciation was included is if you are including depreciation, are you including capital expenditure - double-dipping?

The second one is, you have mentioned intangibles. My understanding of the accounting standards, unless they have

changed, is that intangibles are not depreciable, so why are they included?

THE CHAIRMAN: I don't think we are double-dipping, unless I misunderstand you. We have the return on capital, which is the rate of return on capital, and the return of capital, which is depreciation, which is used up to provide the services.

But then, when you have investment in a new piece of plant or a building or equipment, that goes into the asset base; it doesn't go in through the opex. So it would then influence the prices in the future, because you would have a return on and of the new capital expenditure, but the capital expenditure, as such, does not go in to the building block.

MR TODD: Just on that point, in the slides provided earlier by Veronika, it showed operating, plus capital expenditure, plus the tax equivalents. So if operating includes depreciation and you are including capital, you are double-dipping.

MS HENKEL: The operating expenditure in the building block doesn't include the depreciation. That's just for opex. Then we have an allowance for return on and of capital.

MR TODD: With no depreciation?

MS HENKEL: Not in the opex. So it is not double dipping, it is just once.

MR TODD: But what I am saying is where you have return on and of capital, if you are including depreciation and capital expenditure --

MS HENKEL: We are not including the whole capex. It is the regulatory asset base multiplied by the return on assets, by the WACC. So the whole capex expenditure is not in the building block.

MR TODD: Yes. So it is a return on capital and depreciation; it is not capital expenditure. So you have termed it wrong. When you talk about capital expenditure, capital expenditure is where you purchase to improve capital.

THE CHAIRMAN: We might just get the slide on the block up.

MR KUTSCHUKIAN: We assess the efficient level of capital to include in the regulatory asset base, and then we use the regulatory asset base to determine return on and return of. There is no double-counting there.

The reason we look at capital expenditure is to determine whether what is going into the regulatory asset base is efficient or not in having a look at the items that have been proposed by the Valuer-General. So that's the purpose of focusing on capital expenditure, not because we pass it through, as such.

THE CHAIRMAN: I think on this slide we have the operating and maintenance expenditure, and the answer to the question was that depreciation wasn't included in there, and I wondered where it was, but don't worry, it is actually in the blue bit. And the taxation we have discussed.

The return on assets is the weighted average cost of capital applied to the asset base, and to the extent you undertake capital expenditure, then your asset base would go up and it would be applied to that. The allowance for the return of assets, which is depreciation, which is in there - and it should be in there - will also depend on the size of the assets and the type of assets, and so to the extent you undertake capital expenditure, that would impact on that. And then we have allowance for working capital.

So that way we have the total cost of providing the services, which is competitive neutral to the extent we can possibly get it that way, because it includes taxes, which other private business would have to pay.

MR MOEGE: Sascha Moege, Local Government NSW. Just a question on the depreciation issue. You said you have the land and building asset class in there. So I assume that the full cost of that service potential is allocated to the Valuer-General's cost. How does that relate to the rent expenditure that the Valuer-General also claims in the operational expenditure?

MR GILKES: Land and Property Information owns two buildings - one at Bathurst and one in Queen's Square here

in Sydney. Valuation services actually occupies part of both of those buildings. The share of the depreciation of those buildings has been allocated based on our comparative occupation of those buildings, and there is no rent equivalent or anything like that for those buildings.

THE CHAIRMAN: Thank you very much. Are there any other comments on this item, which is the required revenue? That was a useful discussion. Thank you.

MR EDGERTON: Matthew Edgerton from the IPART Secretariat. I have a question of clarification to LPI and the Valuer-General. In terms of your contracting process, do you contract out all of your valuations or is a portion done by LPI?

MR GILKES: There is a portion done by LPI. There are essentially two forms of valuation contracts that we use. There are our main valuation contracts, which are somewhere in the order of $18 million a year, I think, the vast bulk of the contracting cost, which is for the initial mass valuation services - that is, for making new valuations each year, for making supplementary valuations when the register changes, and the like. All of those services are outsourced and, through a competitive process, those contracts are issued on a three-plus-one-plus-one-year basis and are for a range of exclusive territories across the state.

The other area where we contract valuation services is for undertaking reviews of valuations, objections and the like. Those are contracted from a panel of providers through a series of small RFQs - requests for quotation - for batches of objections of like properties.

LPI, though, does actually carry out some of those services in-house, and there are a few reasons for us doing that rather than using the competitive process to have all of those services provided. At some times in the year we saturate the market and so the competition in the market diminishes dramatically. By carrying out that service on a small subset of objection properties, it actually allows our valuers to do, as part of that process, essentially a quality assurance process on the work of our major contractors. Also, it allows us to keep a certain amount of valuation skill in-house, which in turn provides us with a limited capacity to step in as a provider of last resort in the event of some sort of market failure.

THE CHAIRMAN: Thank you very much, Simon.

MR TODD: Sorry, I did have one more question in relation to operating expenditure. Has the Valuer-General considered electronic service of notices the same way as council can do electronic service of rate notices? The reason being because the cost is 1.3 cents as opposed to a 60, or should I say, 70 cent stamp now? And the fact is that councils are also now required to supply them with, electronically, the changes of address, and they could also supply them electronic email addresses.

MR GILKES: We have over the last couple of years been implementing electronic delivery of notices. We have focused initially on doing that with major landholders to essentially get the system working and the biggest bang for the buck, if you like. It is our intention over the determination period to try to extend that to more landholders through some sort of opt-in process.

One of the issues there, though, is that for the issue of notices of valuation, in most cases we only deal with landholders once every three or four years when new valuations are made for council rating purposes, and so to maintain some of those contact points is problematic in areas where we can't get an up-to-date set of addresses. But it is an area we certainly intend to pursue and expect to see some gains come out of over the coming years.

MR WESTERN: Just quickly, one of the things we are keen to do over the next determination period is to work more closely with councils, particularly where they have access to email information that would assist us in terms of being able to look at sending that out, but there are obviously some privacy issues and things associated with that in terms of obtaining that information as well. So it is not clear cut in terms of doing it but it is an area we definitely want to pursue.

THE CHAIRMAN: Thank you very much, Phillip. Anybody else? I was going to suggest we take a five-minute break.

MR KUTSCHUKIAN: I was just wondering if we could understand a bit about what the efficiency gains going forward are. I noticed from the submission that you are

absorbing a lot of costs, or absorbing some costs, going forward, and would just like to get an idea of what the size of those efficiency gains are in your proposal.

MR GILKES: Well, largely they are unquantified at this point. What I would say, though, is that through the processes we're going through in implementing the recommendations of the joint standing committee, it is meaning we are having to look quite fundamentally at a number of parts of the operation, and in building those new processes, we are also looking at that in terms of the whole end-to-end process.

So, for example, with alternate dispute resolution, which was one of the significant issues that the joint standing committee raised, we are currently going through a process to establish that system, but as part of that, we are also looking at the complete end-to-end objection process, if you like, from the point where a landholder first contacts us through to the ultimate resolution of the matter, to try to identify different ways to streamline that process to balance against the additional effort for the dispute resolution.

So are there any really obvious substantial productivity gains? I don't believe so, and I think that would be borne out by the comparison of our performance against international benchmarks - we already operate at quite an efficient level. Is there opportunity to improve? Absolutely, there always is. But we haven't identified all of those opportunities yet.

THE CHAIRMAN: Okay. Sascha?

MR MOEGE: Can I just ask a general question, probably more to IPART? I just want to get a better understanding of what the degree of testing is that you undertake in terms of cost allocations. I remember, for instance, in the electricity and water sector you do independent testing of those items. To what degree do you do that in this review?

MR KUTSCHUKIAN: For this review, most of the expenditure will be assessed in-house by the secretariat. As far as the Valuer-General's costs are concerned, most of them are service related, so we would be looking to benchmarking most of their costs and then, I guess, assessing how well market-tested the other portion are.

So, in particular, we are focusing on mass valuation contracts, which is one of the largest cost components. To that extent, I could probably throw a question back at you, because I think you are involved in the tender contract panel itself, so your thoughts on those cost increases would be of value, and that would feed into our process, obviously.

So it is a combination of benchmarking and then also understanding whether the tender process is actually open to competition and whether the cost increases asked for mass valuation contracts then are valid, I guess.

MR MOEGE: Just on your question, yes, we are on the tender evaluation panel - Local Government NSW. I think the only thing we could contribute to that is that we have noticed that in regional and rural areas it is often quite difficult to create competition in that market. So you often have just one entity that would provide those services, and you are not quite sure whether the pricing is sufficient, whether it is competitive. So it is a bit difficult in those areas. That's what I could add.

MR GILKES: If I could add one thing there, Sascha has been involved in the process for some years and we are certainly conscious of that issue in regional marketplaces and, indeed, that has become particularly an issue over the last two or three years, I think, where what we have seen in the market for valuation services - and I think this has largely been driven by increasing insurance costs that Phillip mentioned before - is that a number of small businesses have been joining together into network providers. So whereas, when the process started, most towns had a valuation provider, many of those have now joined into the same network, and so don't compete with each other.

What we have tried this year, in order to try to generate more competition in those markets, is we have changed the way that we put contracts to the market, in that whereas previously we would have a determined territory which we would put to the market, and that would comprise one, in the case of the City of Sydney, to many local government areas, and we would put out a fixed body of work, if you like, that firms could tender against, this

year we actually broke a number of those areas up and offered them to the market on the basis that you could bid for one local government area or package many together. The logic in doing that was that it offers the opportunity to attract very small players at a localised level, which may be the sweet spot in the market in some areas, or alternatively, it also gives the capacity for some of the very big players in the valuation market to come to us with a proposal to take on a very substantial area and make the most of their economies of scale.

We don't really know which will ultimately provide the best result, but we believe that this is the best way to let the market tell us what the sweet spot in the market is.

THE CHAIRMAN: Thank you very much, Simon. Any other comments? I was going to suggest we take a five-minute break and then resume the rest of the agenda. Thank you very much.

SHORT ADJOURNMENT

THE CHAIRMAN: Let's move on to item 8 on the agenda, "Cost Allocation to Councils".

MS HENKEL: In the 2009 determination, as we mentioned before, we allocated 40 per cent of the Valuer-General's total revenue requirement to councils. It was based on the proportion of total valuations received by councils annually, which was about 25 per cent; adjustments for economies of scale in valuations for OSR; cost of printing, graphic and postage was fully allocated to councils; and 50 per cent of costs of processing objections.

For the 2014 determination, the Valuer-General is proposing to maintain 40 per cent allocation to councils.

Just some notes on the OSR funding model. The funding from OSR is based on a grant Treasury provides to pay for valuation services provided by the Valuer-General. It is reviewed annually and generally escalated by inflation.

The expected revenue for 2013/14 recovers approximately 60 per cent of the Valuer-General's costs for rating and taxing valuation services. Our terms of reference ask that we allocate the costs of the services between the users in accordance with relevant economic and pricing principles.

The questions we have are: is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated? And what are the implications of the costs allocation to councils, to OSR and the Valuer-General's funding arrangement?

THE CHAIRMAN: Okay. Any comments or discussions on these questions?

MR TOWERS: John Towers, New South Wales Revenue Professionals. I noticed that 100 per cent of printing and postage, et cetera, costs are allocated to councils. Given that councils only receive valuations once every three years from the Valuer-General/LPI, and OSR get them every year - admittedly not the full roll, but a major part of the roll - why is that the case?

MR GILKES: What those costs relate to is actually the posting of notices of valuation, which are only issued when new valuations are issued to council. So those costs are essentially the once-every-three-years posting-out of the notices of valuation in each local government area.

The OSR actually issues the valuations for land tax purposes, so we have no mailing costs associated with that.

MR TOWERS: I have a second question and it relates to 50 per cent of objection costs being allocated to councils. Given that the great majority of objections relate to OSR matters and not council matters - admittedly they affect councils - again, why do councils bear 50 per cent of that cost?

MR GILKES: Based on the most recent figures we had for the last complete year, 60 per cent of the objections related to local government valuations compared to 40 per cent relating to valuations made for land tax purposes.

The reason we wound up at recommending a 50:50 split, which is the way that this was done last time - and, indeed, in our last submission there was a complete rationale around this - was that we recognised that, in general, objections for land tax on properties are more

complex than those for local government. So the bulk of the numbers we saw were in local-government-related valuations, the greater complexity was in OSR, and through a not particularly scientific process we traded those two things off against each other and concluded that a 50:50 split was an appropriate way to do it.

MR TODD: Considering that in this determination you are looking at a five-year period, why are not the objections based upon the average last five years' worth of objections when splitting the costs in relation to objections, rather than a particular year?

MR GILKES: The reason that we took that year - it was a reasonably typical year; we didn't see over that period any great variation and it was fairly typical.

MR TODD: So a five-year average would then be typical, would it? So you have the figures to be able to use that?

MR GILKES: Yes, we would be able to extract the figures for a five-year period and determine a five-year average. As I said, the reason we didn't do that was that, in our view, we thought that that last completed year was - well, there are two things. We thought it was reasonably typical, but also it most closely represents the situation as it exists today.

THE CHAIRMAN: We can look at that. Thanks. Yes, Sascha?

MR MOEGE: Probably just some general comments on the cost allocations to councils. We think - and you have probably seen it from a lot of council submissions as well - that there is probably a need for clarifying the methodology and the testing behind it in relation to the graphic services cost, for instance. I mean, if you read the submission from the Valuer-General, it says that graphic services is a business unit that provides in-house capability in graphic design, desktop publishing, printing, conservation and binding, digital imaging and mail processing and dispatch services. I'm not quite sure whether all of that would be necessarily related just to costs associated with councils. Many councils have asked that question and some of them say they don't see any benefit in the graphic services to them.

In relation to the objections, the same applies: we think that that needs to be better explained, how that is being done. Many councils raised this, and we can't really understand as well. We think that land tax is more contentious, and that certainly has been in the media, and we believe that many objections, or the costs of dealing with them, are related to land tax issues. Obviously councils see a lesser benefit to it, because the accuracy of the valuation is not that critical to them in the rate-pegging environment, where there is no proportional increase in value to what is being rated on a particular property, so the budget is determined by service needs and the rate-pegging limit.

THE CHAIRMAN: But it is important to the person that is being rated, though, the valuation.

MR MOEGE: Yes.

THE CHAIRMAN: On the objections, Simon has already made the point that that was something that was arrived at taking account of the complexity on the one hand and the volume on the other. Obviously, we can have another look at that. But on the first point you raised, which was cost of graphics and things like that - Simon?

MR GILKES: The way that we arrived at that allocation was, as Sascha rightly points out, that graphic services is a business unit within LPI that provides a range of these services. They have a reasonably sophisticated cost allocation system or job costing system, and so the costs that were allocated were the costs directly relating to the printing and issue of valuation-related stuff.

THE CHAIRMAN: Sascha, are you saying that councils get services that they don't want?

MR MOEGE: Well, I was just saying that it wasn't quite clear from the issues paper and the submission, so we would just say that probably it needs to be better explained, how that is being done, so that everybody understands it.

THE CHAIRMAN: Okay, thanks.

MR WESTERN: Might I just add something here. Sascha was talking about the councils and whether there is a need to have the accuracy and the uniformity that is there within the valuation system, that we say needs to be there for

various reasons, and that OSR has a greater need than local government.

That certainly wouldn't be generally my experience. Certainly from a landholder point of view, from the feedback we get through ministerials, through the surveys that we have undertaken and also through the correspondence that comes across my desk, the indications would be clearly that they want a fair and accurate reflection of what their land value is. So, as I said, I would beg to differ with Sascha in regard to that need.

THE CHAIRMAN: Jean-Marc?

MR KUTSCHUKIAN: Just on the graphic services, are they used in objection valuations and, if so, should part of those costs be allocated to OSR, given that objections are obviously split 50:50 between councils and OSR?

MR GILKES: Yes, they do provide some service in that space. However, I don't believe it is material. There are roughly 6,000 objections a year, of which about 40 per cent, as I said before, relate to OSR, and they get one letter each. So in the scale of the overall allocation, I don't think it is material. As I'm sure you are aware, as with any allocation process, there are various swings and roundabouts.

THE CHAIRMAN: Any other comments?

DR PATERSON: A question for Simon. Does LPI have a quantitative process for assessing the value of the economies of scale in servicing OSR vis-a-vis councils?

MR GILKES: This is in terms of the allocation between 60 and 40 per cent?

DR PATERSON: That's right, yes, one of the bullet point items there.

MR GILKES: "Quantitative" would be too generous a description of it. When we arrived at the proposal last time we did consider a whole range of scenarios, and, indeed, in our last submission - which I'm sorry, I don't have with me - we included a table in one of the annexures which actually detailed what the difference would be if there were no valuations made for OSR. So to that extent, yes, it was quantified.

Is that completely scientific? No, but it is certainly the allocation to the best we were able to do it. I am sorry, I don't have those full details, but we can certainly provide those on notice.

MR EDGERTON: Just to confirm, does LPI have any other clients apart from OSR and councils? Does it receive revenue from any other sources?

MR GILKES: Across LPI, yes, we have many other clients, obviously. Valuation services is a substantial part of the business, but not the greatest part. In terms of revenue, the valuation system returns around about $40 million out of $200-odd million total revenue for LPI.

In terms of the valuation information, there are a relatively small number of other clients. The provision of information to those clients, though, is based on simply a data-extract kind of approach. They are minor users. They certainly are not the kind of users that would pay for the creation of this information. They use the information because it exists. We believe, consistent with sound economic principles and the government's open data policies, where we provide information to those other users, typically for non-commercial purposes, it is provided on the basis of the marginal cost of supply. So if there is a particular data extract that needs to be written, the time involved in writing that extract and running it, and so on and so forth, is charged at full charge-out rate. But as I said, it is a very, very small part, and the most significant area of revenue that comes from this is through sales of property sales information.

Once again, that is a service that is not provided from within the valuation services part of LPI, and, indeed, the collection of the sales information, whilst used for the valuation purposes, is actually carried out by the titling branch within LPI, so the costs associated with collecting and calculating that information are not borne by valuation services either.

MR EDGERTON: So just a follow-up question: we talk about the 40:60 split between councils and OSR. As a step before that, what cost allocation is involved in terms of

allocating costs to that aggregate cost pool?

MR GILKES: In terms of those data clients, if you like, they have essentially been left out of the picture here, because the effort in producing that information - and I said the marginal cost of that is charged - is actually carried out by another area within LPI. We have a delivery branch, if you like, who carry out those services, and they recover those marginal costs.

The other area where there is a revenue stream more directly relating to valuations is in terms of what we describe as compensation and special valuations, which is valuations made for compulsory acquisition or valuations provided to other agencies for asset reporting and those kinds of things. They are carried out on a commercial basis and charged at full commercial rates.

Within valuation services, we have a time costing system where everyone's time is recorded against whatever work elements they are working on at any particular time. The proportional time spent on those activities was 8 per cent over the last few years, and so in applying or coming to what I would describe as the rating and taxing valuation cost, we start from our total costs, take away the 8 per cent, first of all, that relates to compensation and special valuations, and then it is the remainder which is divided between OSR and council.

MR TODD: Just on that question where you talked about the other data services, as part of the valuation pricing for the services you provide to us, you talk about a return on your assets. The data that you create through your valuation services is an asset in itself, yet you don't apply that same principle when charging out: you only charge a marginal cost of service to those other data providers. So you are not returning any investment on that asset, which is the data, back to the valuation services.

MR GILKES: As I said, we believe that the pricing policy we have for this is consistent with the government's open data policies, and that's why we have set it that way.

THE CHAIRMAN: Okay. Anything else?

MR KUTSCHUKIAN: I am going back into the opex section here, rather than cost allocation, but a few stakeholders have mentioned that successful objection valuations shouldn't be paid for by them and that those costs should be basically borne by the Valuer-General. I am guessing that relates both to OSR and councils. I was wondering if you had any comments on that.

MR WESTERN: In my introduction I mentioned that we produce 2.4 million valuations every year, and there is obviously a proportion of those that are asked to be reviewed, by landholders, which, as you say, are actually objections.

One of the big issues with a mass valuation system is that by its nature, you are actually valuing properties in bulk. Although you have data associated with each individual property which you can apply, and the contractor has information too, they are not going out and making a single valuation for the whole of the 2.4 million - so you are not doing 2.4 million individual valuations.

So while we work very closely with councils and other agencies in terms of picking up as much data and information in regard to groups of properties or individual properties, there will still be errors in valuations that occur. That, I think, from my point of view, is one of the great things about an objection process - it actually allows for that facility to occur and for the accuracy of the valuations to be improved through that basis.

Put simply, if we were to go out and value every single property in New South Wales every year, I would put it to you that even if we did that, we wouldn't get every valuation absolutely right, in terms of some people's view of that. I make the analogy where you might have two or three valuers responsible for valuing a property in a commercial sense, outside of rating and taxing - they might be doing it for a current market valuation or something, just for a bank - often you will get a variance of opinion in terms of what the value of that property is worth.

My view would be that even if you were to go to the expense of valuing every single property - I'm sure that councils don't want to pay for that - there has to be within the system some form of opportunity for the landowner to have a review, and that's an integral part, as I said, of both the system and improving the quality and accuracy of the valuations.

THE CHAIRMAN: If somebody raises an objection to a valuation that they get - let's say for their council rates - they have to pay to have the objection processed?

MR WESTERN: No, they don't. It is part of the service that is provided. The only time that they would have to pay for something is if they wanted to take, for example, some further expert advice, so they might ask for a valuer to be involved, or something, from outside, to get an independent valuation, which occurs every now and again, or if they have a more complex property, they might want a town planner or something like that. The only other time they actually pay is if they go to court and they pay a registration fee in terms of attending court.

THE CHAIRMAN: Then if they are successful, that is a cost they wear?

MR WESTERN: Yes, correct.

THE CHAIRMAN: I take your point about not doing individual valuations. Could one argue that because we do mass valuations there are going to be some mistakes made, by its very nature, and that that, in a sense, is a cost of that system, and so clearly the Valuer-General picks up, in terms of processing objections, having people to service them - you pick up that cost. Then, if somebody really is determined to pursue it and it turns out that they are vindicated in the courts, they have to pay the registration fee. Another argument might be that maybe the Valuer-General should, which means it will be shared by all the users, because, after all, that is a cost of a system which brings economies of scale when the alternate is completely uneconomic. I think that's Jean-Marc's point.

MR WESTERN: That's absolutely correct. I would just restate what I said in my opening address: the New South Wales valuation system is regarded, from a modern valuation jurisdiction point of view, as being one of the best around. That's indicated, as I said, by the statistical indicators that I read before and the fact that we have numerous jurisdictions actually visiting us to have a look to see what we are doing.

THE CHAIRMAN: Do you take them on Harbour cruises?

MR WESTERN: No.

MR TODD: Quickly, what is the percentage of success rate for somebody who objects?

MR GILKES: I don't have the exact figures, but roughly 50 per cent would be successful, which, bearing in mind that we're talking 50 per cent of 6,000 out of 2.4 million, is a pretty low rate.

THE CHAIRMAN: Other questions or comments on this one, "Cost Allocation to Councils"? No. Thank you very much. Let's move to the next one, which is item 9, "Price Paths and Structures".

MS HENKEL: As we mentioned earlier, in the 2009 determination we set prices by adjusting the 1995 determination prices by changes in the CPI from 1996/97 to 2007/2008, and applied a 1 per cent real efficiency gain each year to the period from 2008/2009 to 2013/2014. We also established a 2:1 price relativity between residential and non-residential valuations. As we said before, the current prices recover about 36.9 per cent of the Valuer-General's required revenue.

Going forward for the 2014 determination, the Valuer-General is proposing to maintain the residential and non-residential prices, maintain the 2:1 price relativity and increase prices by 2.8 per cent per annum in real terms.

The proposed prices achieve full cost recovery for the Valuer-General's services to councils in 2018/19, which is the last year of the determination. However, they result in under-recovery in the years prior to that. The Valuer-General also recommends that we consider using indexation of prices after 2018/19.

THE CHAIRMAN: Questions on this topic, on these issues? Comments? On indexation going forward, did you have in mind indexation based on some cost index, or what else? John, do you want to ask a question?

MR TODD: In relation to where you talk about the price path accounting for customer impacts, councils themselves are impacted every year through rate pegging in the Local Government Cost Index that is established by IPART and the

fact that we have to have, also, a productivity factor, generally 0.02 per cent.

The fact that, from a council perspective, we are not able to pass on any increase above the rate peg, the place we get our money from is the ordinary rate payers, and we are indexed every year by rate pegging.

What should be taken into account is the fact that we are the customers. There is a requirement for the Valuer-General to pay a tax equivalent to the government, therefore, I believe they should be kept the same as councils for the cost to council, that they should be indexed by a cost index plus a productivity factor, and the amount of the tax equivalent should be reduced by any differential sought.

THE CHAIRMAN: The Local Government Cost Index, which IPART established because we were asked to, which underpins the rate pegging, of course attempts to take into account the movement in costs that councils face. This is one cost that you face, albeit it is a very small percentage of your cost. But it is, in theory at least, taken account of through the Local Government Cost Index.

But in terms of the point about indexation in future, I'm taking from you, John, that you think that if one were to adopt indexation for the Valuer-General in future, that it should be on a similar basis to the Local Government Cost Index which, in a sense, drives the rate peg - yes?

MR TODD: Basically, yes. We have to cut services. Whilst it may not be a lot of money to some councils, for us $176,000 a year is our cost in valuers. So we actually have to cut services to be able to pay any increase above the rate peg.

THE CHAIRMAN: Thank you, John. Anybody else on indexation? Yes.

MR SEWELL: Michael Sewell from Campbelltown City Council. On the indexation factor, when the Local Government Cost Index is calculated there is a productivity improvement factor factored in, and I would suggest that if that is imposed on local government, I think it would be appropriate to have a look at that and see whether that could be the case in this escalation factor as well.

THE CHAIRMAN: Indeed, thank you, Michael.

MR KUTSCHUKIAN: I think that relates back to the efficiency savings question that I asked before, and so if we could understand some numbers behind that efficiency saving, we could then compare to the 0.2 per cent productivity factor and make some comparison in our reports. That would be handy.

THE CHAIRMAN: Simon?

MR GILKES: In our submission we indicated that we were in favour of indexation for future reviews. Our proposal was that that be CPI based. Essentially, that was on the rationale that that tends to be a reasonable proxy for what happens to our costs. I'm not familiar enough with the Local Government Cost Index to be able to really make any comment at this stage as to whether that would be equally appropriate or not.

THE CHAIRMAN: Yes. For the Local Government Cost Index, wages is about 60 per cent, whereas for this cost index, wages would be a much greater percentage.

MR GILKES: Yes.

THE CHAIRMAN: So is it fair to say, around the table, that people would be relatively comfortable - once we have done all the analysis - with a suggestion which had it indexed after the end of this five-year determination period? Yes?

MR MOEGE: I think we haven't quite formed a view on that yet. As long as one could ensure that there is some testing of efficient cost and cost allocations occasionally happening in that indexation methodology, then that probably could be a good idea, but there should be an occasional review of that.

THE CHAIRMAN: Yes. What I imagine might happen is that we would do a thorough analysis now, having done one in 2008, and try and sort through a lot of these issues.

A lot of these issues were very well sorted through last time, but we will look at it again, sort through it again, then set the determination. Some time during the

determination we should get to full cost recovery - the Valuer-General suggested in the final year of the determination; there are other options. But once you get to full cost recovery, in future, rather than having a process like this, we could maybe propose an indexation arrangement which went for five years, or something, and then look at it again. In effect, it is a way of reducing red tape.

The problem with indexation is if you have them going for 15, 20 years, things change and it gets all out of whack, but I think the proposal here is that, having had two relatively thorough examinations in 10 years, and two five-year determinations, then maybe you could have an indexation for five years or something like that.

So I am picking up around the table that people definitely think this is worth exploring, so this is something we could work on and we could start to float in our draft report, which gives all stakeholders, including people in this room, a chance to make a written submission and consider the pros and cons of the issue.

MR WESTERN: The only other rider I would make with that is that we would need to have some allowance in there should there be substantive change in either government policy or legislation which impacted significantly upon the costs of running the valuation system.

THE CHAIRMAN: Yes. That's right. Indeed, that would need to be in there for the next determination.

MR EDGERTON: I just have a question on prices, but it also, I guess, refers back to our previous discussion on costs.

We heard before that your costs are largely tracking to what was deemed efficient at the last review, but that going forward you are proposing increases in prices of 2.8 per cent per annum real. Could you just summarise again what the key reasons are for the jump up in costs or the step up in costs between now and essentially next year?

THE CHAIRMAN: Part of that increase is catch-up, isn't it?

MR GILKES: Yes, that's correct. As Veronika said in her presentation, approximately 50 per cent of that increase relates to the catch-up from the 36.9 per cent of efficient costs that the pricing recovers at the moment to the 40 per cent which was agreed at the last determination was a reasonable allocation.

As to the other significant elements, the current increase we are seeing in mass valuation contracts is a significant part of it. That's about 2.5 per cent in real terms in the coming year, we expect. Over the life of the current determination, mass valuation contracts as a whole will be cumulatively very close to what was estimated. However, that was because they increased at a lower rate for a period of time and we are seeing a more significant increase in the latter years.

THE CHAIRMAN: And additional FTEs, I think.

MR GILKES: Yes, there are the five additional full-time equivalent staff we are proposing for the coming year. As I said, one of the ways that we have managed to keep our prices within the current price cap is through not filling positions as a number of people have retired and, as you would have seen, we have actually reduced our staffing pretty significantly over the course of the determination. We believe we have actually gone a bit too far for that to be really sustainable and hence we are proposing that we put back in five of those 23 or so staff that we have taken out of the system.

There are also the elements of the two allocations that weren't in the previous determination - that is, one for spatial information, of which valuation is a very heavy user, and indeed one of the reasons why that information is created in the first place, the capture program is at least partly scheduled around the general valuation program to ensure that there is accurate and current imagery available at the time new valuations are being made for council purposes. And also for the provision of titling information, which are critical pieces of information to support the valuation process and the ongoing maintenance of the register in two forms - that's title searches and images of plans and the like. They are actually products, if you like, that are subject to regulated fees which are regulated by the Minister for Finance and Services, and the way that we have included those allocations, we believe, is quite reasonable and fair. What we have done is we have

allocated what is the wholesale cost of the particular search, the 2013/14 wholesale cost or price, times the volume from the last full year we have.

In the retail sense, there would normally be a delivery fee on top of that for the actual infrastructure that allows them to be delivered. We have excluded that from this purpose, because there is an element here for the capital around those delivery systems.

MR EDGERTON: Sorry, just a follow-up question. You mentioned the additional five FTEs, but we haven't heard any concerns about service levels at the moment. What would happen if you didn't replace all of those FTEs?

MR GILKES: I suspect it will have an impact on service standards. The roles we are looking to fill are those that actively monitor the quality of our valuation contractors and their operations.

There has only been one year where they haven't been in the cost base. They are positions that have become vacant over the last fairly recent period while there have been reviews going on. They are not in this year's accounts because they have been vacant, but, as I said, they were before that. So we probably wouldn't have, at this point, seen any impact from the vacancies, but going forward, I believe we would.

MR WESTERN: And I might just reiterate that certainly from my point of view and a governance perspective, it is absolutely essential that we have the right processes and tools and resources in place to ensure that we can adequately monitor the quality of valuations, obviously to ensure that our stakeholders are getting a good product coming out.

MR KUTSCHUKIAN: Can I just ask a question on OSR's price path over the next few years. On crude maths, you take the 50 per cent catch-up away, then you are asking for a 1.4 per cent price increase, real price increase, from councils. I was wondering about the revenue collected from OSR - is that going to track in the same way or do you expect it to increase at the same rate?

MR GILKES: At the moment, OSR has actually been paying, essentially, a 60 per cent share, so we wouldn't see the need to apply a kind of catch-up approach to OSR, because the gap has been between the 36.9 and the 40 per cent in the local government side. We would expect that OSR's share would continue to be the 60 per cent of the full efficient cost. That's something we have to negotiate with the government.

THE CHAIRMAN: So you would need to negotiate with OSR in essentially the budget process to get an increase in their contribution in real terms to maintain 60 per cent?

MR GILKES: Yes, that's right. Indeed, we go through an annual process of negotiation around the price of these services.

THE CHAIRMAN: Yes. I wonder - I guess that negotiation might be informed by the outcome of this?

MR GILKES: I would assume so.

THE CHAIRMAN: I just wanted to check with people: of the three points on the screen, we have discussed the indexation, I think. I just wanted to touch base on the first two, just to make sure that people in the room are comfortable. Because people, I think, are obviously comfortable - I think "obviously" is the right word - with this trade-off which is made between simplicity and complexity and where you basically only have two prices: you have a residential price and then you have a non-residential price and 2:1 and you charge all councils that price? That's the current approach. I take it that people are comfortable with that approach, which is simple administratively; it is well known and well established.

The next one, which I should imagine councils are very comfortable with, is where you don't achieve full cost recovery until the end of the determination, which means that you have an under-recovery continuing for the first four years of the determination period, and if you recall that graph that Phillip put up, instead of going up like this and then across, it goes up like that (indicating). That obviously means that Simon and his team have to eat that under-recovery for four years. No doubt the councils are pretty relaxed about that, but if anybody's not, let us know. Yes. People understand that, that it is gradually taken up until you get to the point where you have full cost recovery at the end of the period. That's great. Any

final questions or comments before we wrap up?

Thank you very much for coming. It has been very interesting. I, at least, and I'm sure Paul, have learnt a lot in terms of this review. I would like to thank you all very much for your time in coming today and also for those of you who have contributed written submissions. We have benefited very much from the discussion.

A transcript of today's proceedings will be available on our website in a few days' time. We will take into account the outcome of today's proceedings in making our decisions. As I mentioned earlier, we have planned to release a draft report for public comment in April 2014. That report will have about three weeks, because we need to come up with the final report and deliver it to the Premier by the end of May.

Just to remind you again, this is a determination for prices to be set from 1 July 2014. So thank you very much, and have a good day.

AT 12.04PM THE HEARING WAS ADJOURNED ACCORDINGLY