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Submission to IPART's Review of prices for land valuation services provided by the Valuer General to councils (from 1 July 2019)

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LOCAL GOVERNMENT NSW

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Opening

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

LGNSW welcomes the opportunity to make a submission to the Independent Pricing and Regulatory Tribunal of NSW (IPART)'s *Review of prices for land valuation services provided by the Valuer General to councils, from 1 July 2019*.

This submission has been structured to align with IPART's Issues Paper. It has been developed in consultation with NSW councils and with the NSW Revenue Professionals Inc.

Decisions IPART will make before setting prices

1. Should IPART set one 6-year determination, or two 3-year determinations over the 6-year referral period?

LGNSW believes a single 6-year determination would be simpler and less resource intensive than two 3-year determinations. It would also align determinations with two full valuation cycles.

While a single 6-year determination presents some risks in terms of maintaining currency, we note there have been no such issues with the 2014 Determination, which has been for 5 years. We also note the Valuer General's comment that land valuation costs do not generally fluctuate much from year to year. As the Valuer General has suggested,[1] should significant unforeseen costs (or savings) arise the Valuer General is able to submit a supplementary price review to IPART during the determination period.

2. Have the land valuation services provided by the Valuer General changed since the 2014 Determination?

Apart from the changes under the Fire and Emergency Service Levy (FESL) reforms, which were significantly progressed but subsequently deferred indefinitely, LGNSW is not aware of any material changes to the land valuation services provided to councils by the Valuer General since 2014.

It is worth recognising not only the substantial financial resources that were invested in the FESL reforms, but also the effective collaboration between the FESL working group members, particularly NSW Treasury, the Valuer General, LGNSW and the NSW Revenue Professionals Inc, in bringing the FESL to the implementation stage.

[1] Submission to IPART by the Valuer General, 30 November 2018 (p 97)

3. Is the quality of land valuation services provided by the Valuer General meeting customers' expectations?

As the peak body representing local government in NSW, we are well-placed to comment on the performance of the land valuation system and the extent to which it is meeting local government's expectations.

LGNSW has been a member of the Land Valuation Advisory Group (LVAG) since its inception in 2000 and we attend its regular meetings. The LVAG comprises representatives of property industry groups, Revenue NSW and LGNSW. The group provides industry stakeholder oversight, consultation and advice to the Valuer General on the valuation system. LGNSW is also represented on the tender panel for contracts for the provision of land valuation services.

LGNSW has witnessed a prolonged period of continuous improvement in the quality of land valuation services provided by the Valuer General. Feedback we have received from the NSW Revenue Professionals Inc. and from individual councils has been generally positive, with most councils indicating progressive improvement.

We acknowledge there have been important enhancements implemented by Valuation Services over the current determination period and we note the ongoing quality improvements proposed for the referral period, as set out in the Valuer General's submission.[2]

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

Under the rate pegging system, the primary impact of updated land valuations is on the distribution of the rate burden within a Local Government area. Revaluations of established properties do not lead to an increase in councils' total rate revenue. Increases in councils' general revenue are determined by service needs and are limited by the rate peg and Special Rate Variations determined by IPART.

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

4. Is the price cap methodology currently used, the most appropriate form of regulation for setting prices for land valuation services provided by the Valuer General to councils?

Because of its administrative simplicity, LGNSW supports retention of the current price cap approach.

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[2] Submission to IPART by the Valuer General, 30 November 2018 (pp 41-45)

5. What alternative form of regulation should be adopted, if any?

The price cap methodology appears to have worked successfully for the 2014 Determination and there appears to be broad support for its retention in this determination. LGNSW does not propose the adoption of an alternative form of price regulation and we understand neither the Valuer General nor the NSW Revenue Professionals Inc have proposed an alternative.

As a result, we believe a very compelling case would be required to justify the adoption of an alternative form of price regulation.

IPART's Issues Paper puts forward three possible alternative methodologies that could be applied:

1. Weighted average price cap.
2. Revenue cap.
3. Annual cost index

The Paper does not, however, articulate the benefits and costs of these alternatives.

From our assessment, we believe that Option 1 and Option 2 are more complex and less transparent methodologies than the current price cap method, without necessarily resulting in a fairer, more robust outcome.

Furthermore, these two options would provide the Valuer General with the flexibility to vary individual charges to councils, subject to certain constraints. We do not believe it is appropriate for the Valuer General to be afforded this flexibility, given the Valuer General is the monopoly provider of valuation services, and all councils are compelled to use those services.

Option 3 is somewhat like the current price cap methodology and it may warrant further exploration and consideration. However, as noted by the Valuer General and mentioned elsewhere in this submission, the price cap approach already has cost indexation embedded in it.

6. Should an indexation approach be used to set the maximum annual prices for the Valuer General's land valuation services to councils, once an efficient cost base is established?

We note the Valuer General's comment that indexation of the cost base is not necessary as most Valuation Services' costs have inflation built in.[3] If IPART does decide to adopt an indexation approach, it is therefore essential that it removes any embedded allowances for price movements in order to avoid any double counting.

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[3] Submission to IPART by the Valuer General, 30 November 2018 (pp 41-45)

The Valuer General's efficient costs

7. Could the Valuer General use more efficient methods for undertaking mass valuation services?

While LGNSW has no comments regarding alternative mass valuation methodologies, we note from the Valuer General's submission there has been a cumulative overspend of $1.2 million in mass valuation contract costs over the current determination period, which the Valuer General says can be attributed to:

- An inability of some contractors to absorb the cost of higher procedural requirements;
- Contract requirement changes; and
- Increased number of properties in Priority Growth Areas.

LGNSW is concerned about the extent to which these additional costs will be reflected in the Valuer General's Notional Revenue Requirement (NRR) for this determination.

In the first instance, we are not aware of the changes to the contract requirements, so we are unable to assess whether councils should be meeting part of this additional cost and, secondly, we understand that councils in Priority Growth areas are already paying a premium for valuations.

More generally, we note and support the research being undertaken on behalf of the Valuer General into the use of automated valuation models.

8. What are the potential cost drivers that the Valuer General could face in the future that would impact operating costs over the 2019 determination period?

Examples of some key factors that could materially impact on the Valuer General's operating costs over the determination period include:

- A change of government or a change of government policy, such as the current Government's decision, at the 11th hour, to defer the implementation of the FESL.
- Labour cost variances, although with public sector wage increases 'capped' at 2.5 per cent per annum, such variances are of low risk.
- A fundamental change in the way valuations are determined, such as adoption of a Capital Improved Value (CIV) approach.
- Investment in new technology, including the proposed implementation of Valnet III and the digitisation of land valuation information through Service NSW. While such investments are primarily needed to address ageing and inflexible systems, they are also designed to improve customer service standards and to achieve process efficiencies. (Further comment on the Valuer General's capex program is provided below).

- Broader economic conditions, which could influence competition and price in the tender process and potentially impact other operating costs such as rent, postage, travel etc

LGNSW strongly believes - as a matter of principle - that any cost increases resulting from a change of government or a change of government policy (either direct or indirect), should be fully funded by the State Government. Failure to do so would represent another example of cost shifting from the State to Local Government.

Similarly, where there are unforeseen cost increases due to changes sought by, or supported by local government, then councils should contribute to meeting these additional costs.

9. Is it appropriate to use the same methodology for allocating costs from PropertyNSW to the Valuer General as we applied in the 2014 price determination?

LGNSW believes the methodology for the allocation of costs between PropertyNSW and the Valuer General must:

- be transparent;
- be based on sound logic and reason; and
- result in a fair and equitable outcome.

10. Should we take the variable corporate tax rates into consideration in our review of the Valuer General's tax allowance?

LGNSW does not support the inclusion of a tax allowance in the calculation of the Valuer General's NRR. Refer response to Question 11.

However, if IPART continues to include an allowance for tax and tax equivalents in its calculations, LGNSW believes it is appropriate that it also takes into consideration the reduced variable corporate tax rates that are being phased in over the period 2018-2019 to 2026-2027.

11. Should we use the same business unit level for determining the tax rate as we do for determining the WACC, or are there reasons to move away from applying this approach?

IPART has indicated a preference to use the business unit level related to the NRR for the Valuer General's total services, not just the monopoly services provided to councils. IPART notes that this is consistent with its view that the Weighted Average Cost of Capital (WACC) should also be set on the whole of the Valuer General's business.

As we have argued in previous determinations, LGNSW does not consider it appropriate for the pricing of land valuation services for taxation purposes to include a commercial rate of return on capital and we question the concept of applying a business model to a service essential to the functioning of the NSW land tax systems, including council rates.

The reasons for this include:

- The valuation system is an integral part of the state taxation system, it is not inherently a commercial service.
- The use of the valuation services provided by the Valuer General to Local Government is legislatively mandated and is not contestable, so the principles of competitive neutrality do not apply.
- The State Government should not “profit” off Local Government from the provision of this basic essential service.

Allocating efficient costs to councils

12. Is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated?

As noted by the NSW Revenue Professionals Inc,[4] it is not appropriate for the total cost of providing valuations to be allocated only to councils and Revenue NSW. The Valuer General has stated that NSW Roads and Maritime Service (RMS), NSW Fire and Rescue and NSW Crown Lands also have an undisclosed level of access to these valuation records.[5] Other ‘minor users’ identified by the Valuer General include private brokers and the general public.

LGNSW believes there is no reason why these ‘minor users’ (apart from the general public) should not be contributing to the Valuer General’s fixed costs and as a result they should be charged on an average cost basis, not the current marginal cost basis.

Setting prices

13. Should the current price structure of residential and non-residential prices be retained, or is there a more appropriate pricing structure for land valuation services?

LGNSW notes both the Valuer General and the NSW Revenue Professionals Inc have proposed that IPART removes the current differential pricing structure for residential and non-residential valuations. The Valuer General has proposed an alternative differential pricing model (further details provided in response to Question 14), while the NSW Revenue Professionals Inc have proposed a “postage stamp” approach, with single price per valuation.

LGNSW makes the following comments about any suggested change in current pricing methods:

- In its 2014 Determination, IPART found that costs of non-residential valuations are, on average, higher than residential valuations.[6]

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[4] Submission to IPART by the NSW Revenue Professionals Inc. (p 5)
[5] Submission to IPART by the Valuer General (p 84)
[6] IPART Issues Paper (p 29)

- Changing the structure will result in a redistribution of valuation service charges among NSW councils, with both winners and losers (some significant).
- It would have no impact on the Valuer General's revenue or operations.

NSW councils are unlikely to support any change in pricing methods unless it is based on sound rationale and it is accompanied by appropriate transition/compensation arrangements.

14. Should we maintain the current common charge across all councils or move to differential pricing for councils?

LGNSW does not believe there is consensus within local government on whether there should be a common charge for all councils or some form of differential pricing. As a result, LGNSW is not in a position to comment.

We do note however that the Valuer General has proposed a differential pricing model consisting of four geographic regions, based on contract areas.

15. How should the price path account for impacts on customers (i.e., councils)?

IPART is interested in knowing what the administrative costs of differential pricing would be for councils and the budgetary impact.

We understand that the current process requires councils to report annually to the Valuer General on the dissection between residential and non-residential valuations, and this (unaudited) report is then used to calculate the councils' valuation services charge.

As a result, any further disaggregation will directly impact on councils' reporting requirements, although we are not in a position to comment on the financial impact this would have.

LGNSW's comments on the Valuer General's pricing submission

IPART has also sought stakeholder comment on the Valuer General's submission, in terms of the following:

1. Is the Valuer General's proposed operating expenditure efficient?

LGNSW has not seen any evidence in the Valuer General's submission to suggest that proposed operating expenditure is inefficient.

2. Is the Valuer General's actual capital expenditure since 2013-14 prudent?

Over the current determination period, the Valuer General recorded a capex underspend of $5.2 million or 59.1 percent.

LGNSW notes that nearly $2 million of this underspend is due to the deferral of capital expenditure on IT and peripherals during the NSW Government's separation of Land and Property Information (LPI). We are concerned this deferral could impact on the reliability of existing system and on the Valuer General's future IT infrastructure needs, and this should be considered by IPART in making this determination.

3. Is the Valuer General's proposed capital expenditure from 2019 onwards prudent and efficient?

LGNSW notes the significant capital investment proposed by the Valuer General ($25.5 million over the period 2019-2020 to 2021-2022) primarily associated with the implementation of Valnet III and the digitisation of land valuation information through Service NSW.

As stated above, while LGNSW recognises the need to address ageing infrastructure and systems, we are concerned to ensure that these proposed capital expenditures have not been "inflated" as a result of the structural and administrative changes made by the State Government to LPI.

In addition, LGNSW is very mindful of the inherent risks that accompany such significant investments, in terms of cost and/or time blow-outs, and the potential for projected savings and/or benefits to fail to materialise.

LGNSW believes that the anticipated improvements to service standards and to customer interactions, while supported, will mainly benefit commercial customers and individual land owners. IPART should therefore consider making an adjustment to the apportionment of the Valuer General's capital expenditure between councils, Revenue NSW and other customers to better reflect how the benefits among customers will be realised.

4. Is the Valuer General's proposed cost allocation to councils reasonable?

Refer to Question 12 above.

5. Are the Valuer General's proposed prices for residential and non-residential valuations reasonable?

Although the Valuer General has proposed that the current differential pricing structure for residential and non-residential valuations be removed, we note the Valuer General's submission contains proposed prices for residential and non-residential valuations over the referral period if this pricing model is adopted.

Apart from 2019-2020, the Valuer General proposes that prices be maintained in real terms over the referral period, and that the price differential between residential and non-residential be maintained at the same ratio as IPART applied for the 2014 Determination.

For the first year of the determination (2019-2020), the Valuer General has proposed, as part of the transition to full cost recovery, that total prices for Local Government be increased by two percent in real terms.[7] This proposed increase has been justified on the basis of "...the expected

[7] Submission to IPART by the Valuer General, 30 November 2018 (p8)

increase in forecast mass valuation and objection contract costs to recalibrate for the underspend in the current determination period reflecting the recent history in variations".

The Valuer General has argued this proposed real terms increase is "…a small increment … this can be absorbed by councils…" and that no transitional arrangements or rebates are required.[8]

LGNSW has serious concerns about this proposed price increase. Specifically:

- We do not believe the Valuer General has provided enough costing information, or set out a sound case, to explain:
    - why a real terms increase is necessary; and
    - why an increase of 2 per cent is justified;
- We do not accept the view that this is a small amount and that all councils can absorb the increase.

Increases in councils' annual rating income is subject to a statutory limit, which is designed to reflect annual cost movements for councils. Where changes in costs or prices exceed the rate peg amount, any shortfall must be met by reducing service levels or increasing fees or charges. In doing so, this further adds to the level of cost shifting from the State to Local Government.

[8] Submission to IPART by the Valuer General, 30 November 2018 (p77)