

**Submission
No 105**

INQUIRY INTO LAND VALUATION SYSTEM

Organisation: Ombudsman New South Wales

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7 March 2013

Your reference: LAC13/027
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Mr Matt Kean, MP
Committee Chair
Joint Standing Committee of the Valuer General
Parliament House
Macquarie Street
Sydney NSW 2000

Dear Mr Kean

Inquiry into the Land Valuation System

I am writing in response to your letter of 7 February 2013 inviting me to make a submission to the Committee's inquiry. As the Committee may be aware, my office completed a detailed investigation into the land valuation system in NSW. The special report to Parliament released at the conclusion of that investigation is included for the Committee's information, and can also be accessed at our website.

Please do not hesitate to contact me if the Committee would like any further information to assist in its inquiry.

Yours sincerely



Bruce Barbour
Ombudsman



NSW Ombudsman

IMPROVING THE QUALITY OF LAND VALUATIONS ISSUED BY THE VALUER GENERAL

A special report to Parliament under s31 and s26 of
the Ombudsman Act 1974

October 2005



Improving the quality of land valuations issued by the Valuer General

A special report to Parliament under s31 and s26 of the Ombudsman Act 1974

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The Hon Meredith Burgmann MLC
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The Hon John Acquilina MP
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Dear Madam President and Mr Speaker

I submit a report pursuant to s 31 of the Ombudsman Act 1974. In accordance with the Act, I have provided the Minister for Lands with a copy of this report.

I draw your attention to the provisions of s 31AA of the Ombudsman Act 1974 in relation to the tabling of this report and request that you make it public forthwith.

Yours sincerely

Bruce Barbour
Ombudsman

Introduction

The purpose of this report is to bring Parliament's attention to the findings of an investigation into the quality assurance measures employed in the NSW land valuation system used for rating and taxing purposes. The investigation also examined the handling of objections to valuations including the provision of information to potential and actual objectors.

The investigation found that the methodology employed to produce land valuations in NSW, the component system of mass valuation, was generally sound. However, weaknesses in the implementation of the quality assurance framework means the system is producing an uncertain number of values that have unacceptable margins of error. More needs to be done to fine tune the process to encourage a greater level of accuracy and confidence in the valuations entered into the Register of Land Values.

The investigation has made 38 recommendations aimed at assisting this process. The Valuer General has accepted all the recommendations made to him and has already undertaken action to implement many of them. Some legislative change is recommended and thus requires further consideration by Parliament.

Executive summary

Continuing concerns about land valuation

Land valuation is a subject of public interest and some controversy due to its impact upon liability for land tax and council rates. Despite a number of previous inquiries, public dissatisfaction with land values has continued in recent years prompted by a volatile real estate market and changes to the land tax system. In November 2004 the Ombudsman initiated an investigation following the receipt of a complaint claiming that there had been a complete breakdown in the administration of the system of mass valuation whereby it allegedly had become “totally corrupted and completely unreliable”. The previous major inquiry into the land valuation system conducted by Julie Walton in 1999 (*Report of Inquiry into Operation of Valuation of Land Act*, NSW Government, October 1999) had placed a significant emphasis in its recommendations on the need to develop better quality control measures and incorporate a quality emphasis into valuation contracts. The Ombudsman’s investigation therefore performed a ‘health check’ to see how well those developments had been incorporated and were functioning based on a review of practices implemented during the 2004 valuation program.

Mass valuation

A system of contestable contracts for the provision of valuation services has been in place since amendments to the Valuation of Land Act in 1996. Eight firms of contract valuers use the component methodology of mass valuation to make valuation recommendations to the Valuer General in respect to each property in the 173 local government valuation districts in NSW. The Act requires the Valuer General to issue valuations based upon these recommended valuations and provides that he may make the valuation without independently assessing the accuracy of the recommendation.

The Act does, however, require the Valuer General to monitor the standard of valuation services provided under these contracts and to make assessments of the compliance by contract valuers with procedural and other requirements of the Act, regulation and the applicable valuation service contracts.

District valuers within the Land & Property Information Division of the Department of Lands (LPI) act as contract managers for the Valuer General to monitor actual performance of the contract valuers. Assessed against the Contract Management Better Practice Guide framework of the Australian Audit Office, the contract management process was found to be generally satisfactory. For instance, a commercial contract defined the business relationship between the Valuer General and the contract valuers, a procedures manual guided the performance of services and a service level agreement was in place to detail the standard of service expected from LPI. In addition, senior management was supportive of contract managers encouraging a relationship of trust with contractors and provided contract managers with sufficient authority for the day to day management of the contracts. Contract managers were also highly experienced in the valuation process with the ability to solve problems in a timely way. However, some weaknesses were identified including:

- Appropriate and effective methods for measuring and monitoring contractor performance have only recently been introduced
- There are still no targets incorporated into contracts, procedure manuals or the service level agreement that address continuous improvement and no current performance measurement systems in place that monitor the outputs of contractors or the levels of accuracy and completeness of the valuation recommendations they make over the program years of their contracts
- LPI has insufficient district valuers to properly cover the contract management duties in respect to all existing contracts. Regional Valuers are forced to take on contract management duties at the expense of auditing and reviewing the contract management process to ensure consistency across the regions.
- Not all contract managers have been provided with training in contract management principles. Additionally, the failure to provide contract managers with training on the application and interpretation of the new quality statistical measures undermined their effectiveness as quality measures in the 2003 and 2004 valuation programs as the significance of non-compliance was poorly understood. Record keeping by contract managers on the whole is extremely poor and it was not possible to confidently verify whether expected functions were always performed or to measure the outcomes.

Component valuation methodology

Under the component methodology of mass valuation, local government districts are subdivided into components made up of properties that have similar characteristics whose values are expected to move at similar rates in the real estate market over time. Some districts have as few as 8 components whereas a number have more than 150. Within each component there are one or more benchmark properties. These are properties chosen because they are representative of the majority of properties, or in the case of multiple benchmarks, because they are representative of different value levels within the component. Benchmark properties are valued most commonly by the comparison method whereby sales of comparable vacant land or improved land are relied upon to estimate the land value of the benchmark. This is also informed by a broad market analysis of movements in value within the district. The benchmark value is then divided by the issued valuation for the previous year to produce a factor increase (or decrease). Component factors are then determined based upon the factors demonstrated by the benchmark factors. The component factor adopted is the factor that will adjust the largest proportion of properties within the component to their current market land value. Once determined, the component factor is applied to the previous valuation of all properties within the component. Contract valuers then verify those values. This verification process is mostly done by desk audit but may involve a physical inspection and the use of traditional valuation methodologies. Where necessary, individual values within the component will be adjusted to give a result closer to the market value.

Since the introduction of contestable valuation services contracts, the cost of valuations has reduced in real terms. However the productivity savings arising from the deployment of reduced resources has started to impact on the quality of the valuations and may have reached the point where the costs cannot be driven down further without seriously undermining the methodology.

Our investigation identified concerns about a number of the processes that underpin the component methodology and impact upon the accuracy and uniformity of valuations.

Sales analysis

The core of the valuation program is the sales analysis conducted by the valuation contractors. Best evidence of market changes comes from sales transacted closest to the 1 July base date each year. The lag in registration of sales close to the base date means contractors do not always have the most up to date sales data at the time they submit their proposed component factors. There tends to be a heavy reliance upon sales transacted in the early months of the year. In a sample of 44 districts we found only 6 relied upon more than half their sales being within 2 months of the base date. We found 44% of sales were transacted between 2 and 6 months before the base date and nearly 25% were between 6 and 12 months old.

Analysis of sales requires the land value to be deduced from the sales price, and if necessary, for it to be adjusted for time to bring the value up to the base date so it can be compared to others. Valuers increasingly rely upon sales of improved properties rather than vacant land sales due to the scarcity of the latter and a recent court precedent. Currently there is an absence of a uniform methodology for valuing improvements. Variations in approaches adopted by contract valuers introduce another factor that may contribute to a margin of error and inconsistency across districts in the valuation of land.

We also found an absence of a uniform methodology to adjust sales for time. There were many anomalies in the time adjustment factors used and many instances where analysed land values were not adjusted for time despite obvious movements in the market. In a sample of 39 districts, we found over 40% had not adjusted any of the sales for time and a further 20% had adjusted 10% of the sales or less. The analysed and adjusted land values derived from sales analyses are used to value benchmark properties. If those valuations are based upon comparison sales that have not been adjusted properly, the valuation may be defective. As benchmark valuations are used to derive component factors, which in turn are used to generate new valuations, a domino effect is possible reducing the reliability of the resultant values.

Integrity of the building blocks

The integrity of the final valuations arrived at by the component method of mass valuation is based upon a number of building blocks which themselves must have integrity. The two most critical are the allocation of properties into homogenous components and the choice of representative benchmark properties.

Components must be well chosen initially and then continually reviewed to ensure the attributes of the properties used to group them together remain the important determinants of the change in their land values. Valuers use a statistical measure based upon the inter quartile range of values in each component to test for component homogeneity (the QRP). In a sample of 90 valuation districts we found nearly half the components did not meet the acceptable QRP standard indicating the need for scrutiny to ensure they consisted of truly comparable properties. Concern focuses more on residential zones where nearly a quarter of components were still outside the standard. There can be legitimate reasons why components may not meet this standard so these results should be used as a flag to prompt investigation of component make up. However, we were not confident that contract valuers did any substantial investigation work in response to these non-conforming results. There appeared to be a significant reliance upon subjective assessment of homogeneity by some contract valuers. There also does not appear to be any records kept by contract managers of any progressive review of components over different valuation years. This suggests there is little scrutiny if any of the effect on valuation outcomes from year to year following component and benchmark reviews.

Benchmark properties are required to be within the inter quartile range and the Valuer General currently further requires them to be within plus or minus 5% of the median value level within the component. There is widespread non-compliance with this latter standard. We found 61% of residential components across the state did not meet this standard and non-compliance was even higher in other zones. In a sample of 90 valuation districts, 28% of the components had benchmarks that were not even within the inter quartile range. In the absence of multiple benchmarks, the risk of a benchmark property not being representative of the value movements in the component increases where it does not fall within the middle value range. Again, while contract managers are drawing the attention of contract valuers to the need to review non-conforming benchmarks, we found no clear system for documenting the outcome of such reviews and assessing whether they were satisfactory or not.

Calculating movement in values

Once benchmark properties are valued and their factor increase (or decrease) from the previous valuation is calculated, this is used as the basis for the component factor which is then applied to the rest of the properties in the component to derive their new valuations. Our investigation found evidence of a number of practices that departed from this basic methodology, two of which resulted in factors being more conservative than the benchmark valuations would otherwise indicate.

For example, in Kiama in 2004, 87 of 91 components had adopted component factors that were less than the respective benchmark factor. This resulted from the practice of the contract valuer 'rounding down' component factors to the nearest multiple of 5%. This is not an approved practice and should be discouraged. In Greater Taree, component factors in most cases were determined by reducing the benchmark factor by 10%. This came about following advice from the Regional Valuer that encouraged contractors to adopt a level of value to ensure a result as close to 90% of market value as possible. In Hastings, the reduction on average was 3%. The Valuer General and Chief Valuer were unaware of this and highly critical of the action. While the practice of applying a conservative component factor in areas where there is little sales evidence is defensible as a valuation practice, the major concern of practices such as this being applied in some valuation districts but not others is that it undermines the consistency of the valuation process across the state. From a rating and taxing perspective, it also could imply that government bodies are short changed in those districts because of systematic undervaluation.

Quality checks of valuation outcomes

The investigation found a number of the quality checks of the valuation outcomes were wanting.

While contract managers generally conducted data integrity checks in accordance with the Contract Managers Procedures Manual, time constraints between receipt of value files from contract valuers and deadlines to accept values mean most of their time is taken up resolving the more simple data integrity checks. Limited if any time appears to be spent on other discretionary checks that are potentially of more value to identify problems with actual proposed values.

In 2002 independent valuers checked a sample of valuations, which revealed some significant discrepancies of valuation opinion. No further check valuations have been conducted since 2002 for timing and resource reasons. The Valuer General is re-introducing this program in 2005.

Apart from check valuations, and reviews conducted by way of objections and court appeals, the principal objective quality assurance measures to determine the level of accuracy and uniformity of valuations are statistical measures. These were introduced initially in 2003 and now every valuation contract requires them. They are based on the comparison of valuations made under the mass valuation system for properties with evidence derived from the analysis of the actual sales of the properties. The investigation reviewed the statistical outcomes for a sample of 90 valuation districts where reports were required by contract in 2004 or were otherwise available.

The Australian standard of a margin of error in mass valuations of + or – 15% is in line with international practice. The Valuer General adopts this standard in one statistical measure but the procedures manual inconsistently expects a 5% margin of error in another. The investigation was able to compare outcomes against these measures for residential sales in a sample of 43 valuation districts in 2004. We found only 31% of sales on average met the strict 5% margin of error and only 66% of sales across the sample were within the acceptable 15% margin of error. The distribution was not uniform. We found 21% of the sample districts had more than half their sales outside the acceptable 15% standard and 44% had more than 40% of their sales outside the range. In six districts more than two thirds of the sale properties had variations of more than 15%. Further analysis revealed almost one in six districts had more than a third of their sales with percentage errors above 25% and almost a quarter had more than 10% of their sales with variations more than 40% between the adjusted analysed land value and the issued valuation. Variations in the vast majority of cases indicated the issued valuations were less than the market-recognised value, i.e. there is undervaluation across the districts of New South Wales rather than overvaluation. Extrapolated to the whole population in each district, these figures are extremely worrying as indicators of the standard of valuation accuracy currently being achieved under the component method of mass valuation.

The Valuer General employs three more sophisticated statistical measures to provide combined measures of accuracy and uniformity. Accuracy refers to the closeness of valuations to actual prices whereas uniformity is a measure of the consistency of the percentage errors across a sample. Nineteen per cent of residential districts had coefficients of dispersion outside the acceptable standard. Only 66% of districts with residential zones met the mean value price ratio standard and 24% of districts had a price related differential outside the acceptable standard. These are not infallible measures and some caution needs to be applied to interpreting the level of non-conformance as solid proof of critical defects in the component method of mass valuation. However, they are still the best evidence available of potential problems with accuracy and consistency of valuations. The non-conforming statistical outcomes rightly need to be used as flags or indicators of problems that need to be further investigated to determine whether there is in fact serious inaccuracy or lack of uniformity in the valuations made.

Interviews with contract valuers and contract managers indicated little attention has been paid to the statistical outcomes to date. The measures were put in place in 2003 without any thought given to how the outcomes should be monitored. It was basically left to contract managers to review on an individual district basis. In an audit of district files, we found only two of the ten files where the district had non-conforming statistical results contained a written record of an explanation from the contractor. The Valuer General in November 2004 had sought explanations from contract managers of why they had accepted values where the statistical measures were outside the parameters and the subsequent action taken. The responses he received were hardly comprehensive. None of the explanations provided an adequate account of why particular measures were outside the parameters. The failure to obtain detailed explanations for non-conforming statistical results means it is difficult to have confidence in the integrity of the values produced. More discipline needs to be exercised by contract managers to find out why values are not meeting the standards expected by the Valuer General and what needs to be done to correct the situation.

Generally there appeared to be a low level of understanding about the meaning and potential impact of non-conforming statistical results among contract valuers and contract managers. None had received any training in the application and interpretation of the statistical measures prior to the 2003 and 2004 valuation programs. This was rectified during our investigation.

The principal cause for concern however, is that the presentation of non-conforming statistical results occurs at a time when little or nothing can be done to investigate their implication before the proposed values are adopted.

Dealing with objections

It is clear that many people are having difficulty coming to grips with the complexities of land valuation. The heightened interest in property as a means of wealth accumulation and security has driven and in turn been driven by a significant amount of information about property prices and the real estate market available through the media and the Internet. This information has not necessarily clarified land valuation for rating and taxing purposes in the minds of the public. Many land owners appear to still distrust the integrity and independence of the objection process.

The investigation found that the review of objections was far more thorough than many people believed. However, there is still room to make it more transparent, consistent and accountable.

While there are common practices, there is currently a lack of a formalised and standardised objection procedure and documentation. A draft Objection Procedures Manual was only developed in May 2004 and is still not finalised. This should be finalised and implemented as soon as possible.

Similarly, objection processing documentation needs to be reviewed. Standardising the objection worksheet and control sheet consistent with the steps in the manual will aid consistency and go some way to demonstrating how a determination was reached and the reasons for the decision. Currently, notices of determination of an objection insufficiently account for the reasons for the decision and do not identify the decision-maker. The notice of determination often masks the thoroughness of the review undertaken and leaves objectors sceptical of the seriousness with which their objection has been dealt.

A lack of ongoing systematic analysis of objections trends and outcomes also impedes consistency. The Valuer General should develop guidelines and an action plan for the system level review of objection trends and outcomes.

Independence of decision-making is central to how the objection process is perceived. To remove any possible perceptions of constraints on LPIs willingness to assess objections on their merits or to re-asertain values, the Valuer General and the Chief Valuer should review the Service Level Agreement with LPI to properly reflect LPI's responsibilities.

The Valuer General has taken commendable steps towards making the objection process more easily accessible and transparent. However the more rigorous screening process may disadvantage objectors lacking knowledge and access to resources unless guidance provided with the new, mandatory Valuation Objection Form is improved and more relevant information is provided to objectors and potential objectors making initial inquiries.

The grounds for objection are only briefly described in the Valuation Objection Form. The most relevant information about sales used to support valuations is not provided to objectors unless they speak directly to a contract manager and ask specifically for it to be provided. The Valuer General should develop some model objections based on the most widely used grounds for objection which should also be accompanied by clearer explanations and supporting information. Even though the Valuer General has implemented better access for objectors to sales information through the General Valuation Sales Report and individual valuations through the Department of Land's website, the analysed adjusted land value of sales properties should be included in the General Valuations Sales Report and made available to objectors and potential objectors. Should the use of a call centre be retained in future valuation programs to deal with initial objection enquiries, a system should be implemented to enable staff at the centre to access and distribute the appropriate General Valuation Sales Report to satisfy the enquirer's information needs.

General conclusions

Mass valuation systems are used throughout the world and are an economic and logistical necessity. The component system of mass valuation is capable of producing estimates of value within a reasonable margin of error for the majority of properties, and is theoretically a self-correcting system so that it should converge to the true values over time. The investigation was also satisfied that the quality assurance framework in place, including the objection process, was reasonable, however, it has a number of weaknesses in its current implementation most of which are the product of resourcing and scheduling issues. These contribute to the system currently producing some values that have unacceptable margins of error.

While the range of properties that are subject of objections is unlikely to be representative of all valuations made, the fact that in previous years one in five objections resulted in the valuations being overturned, and that for a substantial number of objections to the 2004 valuations processed to date, approximately one in four have been allowed itself reflects poorly on the general standard of accuracy achieved.

The main factors contributing to the production of anomalous values identified in the investigation were:

- The deterioration in the quality of base line data –it is generally accepted that the cumulative application of factors over time leads to the distortion of the relativity of values in an area and that the base line should be revisited and reviewed periodically. International best practice suggests this should happen at least every six

years. In NSW we have gone 16 years without any systematic review and correction of base line valuation data. There needs to be a regular, structured program of handcrafting and review of the structure of components to 're-set' the base line data.

- Inadequate time to undertake valuations – the time between the base date and the submission of component factors and proposed values currently is too short to enable proper access to and analysis of the most relevant market data – the sales closest to 1 July each year. It also negatively impacts on the capacity of contract valuers to develop initial values and test that data through the application of statistical quality assurance measures and verification exercises. Moving the base date back three months but only slightly modifying submission dates would resolve this.
- Inadequate time and resources for contract managers to quality assure proposed factors and values – the compression of time between submission of proposed values and acceptance of those values is the most significant timing problem. Most contract managers spend what is normally only a few days running serial data integrity checks but have little or no time to assess the actual quality of the proposed values. If the quality statistical measures provided at the same time indicate non-compliance with standards, there is literally no time to do anything about it. At best, contract valuers are asked to investigate and attend to the issue during the next valuation program. This unsatisfactory practice ignores potential inaccuracies in values and defers their resolution to the next year without there being any guarantee that this will in fact happen. Changing the base date would also help resolve this timing problem.
- Inadequate observance of standards for component composition and benchmark selection – there is a relatively high number of components across the state that have high ranges of variation in values and do not meet the currently prescribed acceptable indicator of homogeneity (a QRP statistic below 50%). In the absence of sound qualitative or alternative quantitative measures of component homogeneity, there is insufficient available evidence to assure the Valuer General that these non-conforming components are indeed homogenous. There is also an extremely high rate of non-compliance with the prescribed standard for benchmark properties. There needs to be a critical assessment of all of these non-conforming benchmarks and a proper acquittance of them through either an explanation of why their continued use is satisfactory or their progressive replacement or the use of additional conforming benchmarks.
- Inadequate monitoring of component and benchmark reviews – to maintain the integrity of the key building blocks of the component system of mass valuation requires continual review and fine tuning of components and benchmarks due to the changes that occur over time in the value relationships between properties within components. Contract valuers are responsible for this but there is inadequate monitoring of these reviews over different valuation years at the contract level or the wider system level. It is therefore impossible to verify whether satisfactory reviews have been carried out or not. Proper action plans need to be drawn up and proactively monitored.
- Inadequate monitoring of valuation outcomes – apart from obvious anomalies picked up through data integrity checks, up until the 2003 program there appears to have been little if any quantitative quality analysis performed of proposed values put forward by contractors prior to their acceptance. Even since the introduction of quality statistical tests, there appears to have been little or no attempt to systematically assess the level of compliance with those measures or to assess the sufficiency of action taken in non-complying districts at a system level. Consequently there is an over-reliance upon the objection system to correct any inaccuracies in values produced by the component method. More can and should be done to identify anomalous values before they are accepted into the Register of Land Values.
- Inadequate resourcing of the contract management function – the ability of contract managers to perform a high quality service is currently severely limited by the time they have available to perform many of the quality checks they are expected to do. Training in basic contract management skills has not been provided to all contract managers and even training on key issues such as the use and interpretation of the statistical measures that have been included in contracts since 2003 was only introduced during the course of this investigation. Regional Valuers are unable to meet the requirement for continuous internal audit of contract management practices, which is a central component of the quality assurance framework, because they also have to perform the duties of District Valuers. Resources are stretched too thinly.
- Poor quality control of objection processing – while the objection process on the whole is thorough, there is inadequate accountability and consistency in processing due to the lack of a procedures manual and standardised documentation. There is also a lack of ongoing systematic analysis of objection trends and outcomes. The public's views of the independence and transparency of the objection review process would be enhanced by clearer delineation of decision-makers' responsibilities and the provision of relevant adjusted analysed sales information and guidance about grounds of objection to objectors and potential objectors.

The Valuer General with the assistance of the Chief Valuer has introduced many commendable initiatives to improve the operation and reliability of the mass valuation system in NSW since their respective appointments in late 2003. There is still much to be done. The report on the investigation makes the following 38 recommendations aimed at assisting that ongoing quality improvement program to better ensure the accuracy of valuations and the handling of objections.

Report recommendations

- 6.1 The Valuer General introduce a structured program of handcrafting and review of component structures to 're-set' the valuation base line in the majority of districts of NSW.

The Valuer General should use the model of the Wollondilly contract and also explore other alternative approaches to achieve this. Variations to key existing valuation services contracts to cater for these additional services should be offered and the requirement for these additional services progressively introduced into new contracts as they become available. Priority should be given to those districts where the statistical measures indicate high levels of non-compliance with the expected standards, where there are high rates of successful objections or where value changes have been most pronounced. At least a third of valuation districts should be targeted to be completely re-assessed within the next five years.
- 6.2 The Minister initiate action to seek Cabinet endorsement to amend section 14B of the Valuation of Land Act to provide for land to be valued for the purposes of a general valuation at 1 March in the valuing year in which the valuation takes place.
- 6.3 Subject to a change in the valuation base date, the schedule for the production of proposed values by contract valuers be amended to provide a reasonable time buffer for contract managers to perform an expanded range of data integrity and other quality checks to better ensure a high level of accuracy in values prior to their adoption and entry into the Register of Land Values.
- 6.4 Investigate the means by which contract valuers can be required to provide statistical measures prior to the production of proposed values so that any necessary remedial action can be fully explored in relation to non-conforming measures prior to the uploading of values into the Valnet system.
- 6.5 Develop a quality control checklist detailing the full range of data integrity and statistical tests that contract managers be required to run before accepting proposed values that requires contract managers to attest to each test meeting the Valuer General's standards or where they do not meet such standards, attest to the receipt of documented and satisfactory explanations.
- 6.6 Develop other statistical measures and reports to identify unacceptable variations in proposed values.
- 6.7 At the completion of each valuation program and based on a review of compliance with the applicable quantitative component composition and benchmark standards and any other relevant information, contract managers in consultation with contract valuers should draw up a prioritised and detailed action plan for the review of non-conforming components and benchmarks and closely monitor such reviews ensuring that there is an acceptable and recorded acquittance of each non-conforming entity prior to the commencement of the following valuation program. Priority should be given to replacing those benchmarks lying significantly distant from the median value in components with low degrees of handcrafting.
- 6.8 Require contract managers each year to conduct an analysis of and report upon the improvements made in each district in terms of compliance with statistical measures, the effects of changes made to components and benchmarks and general compliance by contractors with their contractual obligations.
- 6.9 Develop a system level overview analysis of key statistical results across districts that is able to track progress in compliance with standards and identify trends.
- 6.10 The Valuer General publish in his annual report performance information on contract valuer compliance with key quantitative standards against base line benchmarks.
- 6.11 The Department seek a budgetary enhancement to employ sufficient additional District Valuers to properly manage valuation services contracts and enable regular contract management auditing.
- 6.12 That a methodology be developed for the Regional Valuer contract management audits referred to in section 1.3.6 of the *Rating & Taxing Valuation Contract Management Procedures Manual*.
- 6.13 Ensure all contract managers receive training on principles of contract management and record keeping relevant to the management of valuation services contracts
- 6.14 That a needs analysis be undertaken towards the end of the 2005 valuation program to identify further training needs of contract managers and contract valuers in the use and interpretation of key statistical measures and that further statistical training be provided based on the findings of that analysis.
- 6.15 That application of a uniform methodology for the valuation of improvements for purposes of undertaking sales analyses be encouraged by the incorporation of suitable guidance in a revised *Procedure Manual for Contract Valuers*.
- 6.16 That application of a uniform methodology for the adjustment of sales for time be encouraged by the incorporation of suitable guidance in a revised *Procedure Manual for Contract Valuers*.
- 6.17 That the *Procedure Manual for Contract Valuers* require contract valuers to provide explanations of the basis of their adjustment methodology.

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- 6.18 That the directions contained in the *Procedure Manual for Contract Valuers* for the sales to be used in calculating the quality statistical measures be amended to exclude any sale where the assigned value was not produced by the application of a component or sub-component factor.
 - 6.19 That the *Procedure Manual for Contract Valuers* be amended to provide that component factors should not be rounded down.
 - 6.20 That the component check form be re-designed to take account of the observations set out in section 4.5.2.8.
 - 6.21 That LPI consider the need for a report to update contract managers on a monthly basis of the total number of sales in their districts to assist their assessments of the sufficiency of sales analyses by contract valuers.
 - 6.22 That consideration be given to the usefulness of including in Valnet a field that would indicate whether a value was completely handcrafted or was a factorised value that was verified.
 - 6.23 That the Valuer General provides suitable guidance notes for potential objectors on the type of information that would support 'model' objections.
 - 6.24 That relevant sales schedules showing adjusted analysed land values that were relied upon to make or support valuations be made available to potential objectors as a matter of course.
 - 6.25 That the Valuer General include in his annual report statistics about the number of objections and appeals processed and their disposition.
 - 6.26 That a flag be incorporated into Valnet to identify whether a later valuation has been issued once a value amended on objection is entered.
 - 6.27 That the objections procedure manual be amended to require assessment of any later issued valuation as part of the standard objection determination.
 - 6.28 That the objection procedure manual be amended to require assessing officers to consider whether any adjacent values need to be re-ascertained if an objection is allowed.
 - 6.29 That a standard objection worksheet be developed that more clearly provides for the documenting of reasons for objection determinations.
 - 6.30 That the standard of objection determination correspondence be increased including the review and reformulation of the use of standard paragraphs.
 - 6.31 That the delegated decision maker be identified in objection determinations.
 - 6.32 That the objection procedures manual be finalised as soon as possible.
 - 6.33 That the Valuer General review the Service Level Agreement with LPI with a view to removing (a) any KPI target that relates primarily to the performance of contract valuers rather than LPI, and (b) any KPI target relating to re-ascertainment rates or allowable objections that could be perceived to restrain LPI from properly using its professional discretion in performing its duties in relation to these functions.
 - 6.34 That the standard service obligations in the model valuation services contract be amended to include an obligation to keep under review and maintain appropriate components and benchmarks to ensure the integrity of values produced using the methodology.
 - 6.35 That the Joint Committee on the Office of the Valuer General conducts a cost/benefit review of amending the Valuation of Land Act to provide for the issue of annual valuation notices.
 - 6.36 That the Joint Committee on the Office of the Valuer General monitor compliance with the key quality statistical standards of the Valuer General as part of its annual program.
 - 6.37 That the Joint Committee on the Office of the Valuer General review the results and implications of the 2005 check valuations project as part of their general overview of the methodologies employed for the purpose of conducting valuations under the Valuation of Land Act.
 - 6.38 That the NSW Treasury examines the desirability of basing land tax assessments on a rolling 3 or 5 year average land value rather than annual land valuations.

Report under Section 26 of the *Ombudsman Act*

Valuer General & Department of Lands

Investigation into :

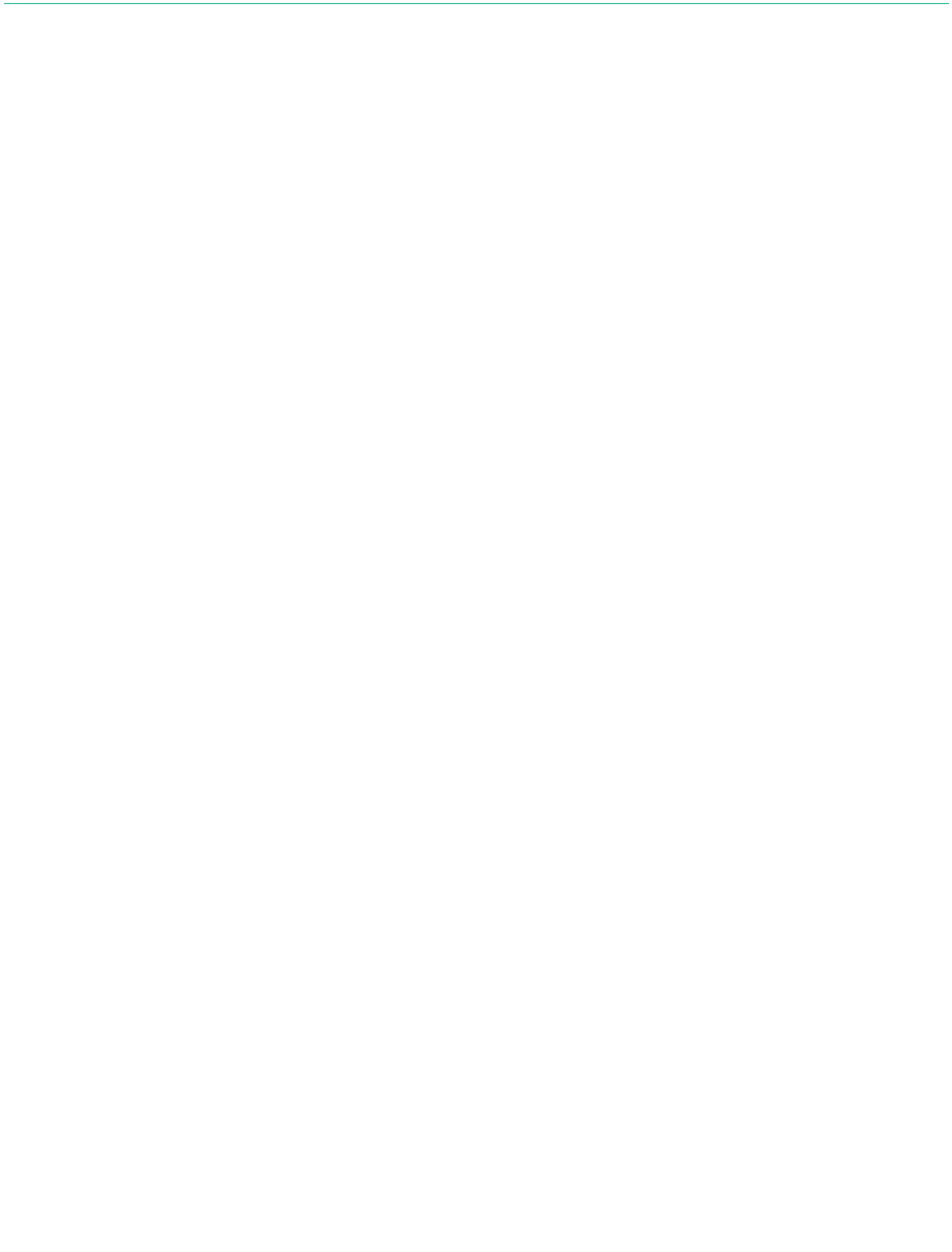
1. The controls employed by the Valuer General to ensure the accuracy of valuations derived by the component method of mass valuation in valuation districts of New South Wales
2. The handling of objections to valuations including the provision of information to potential and actual objectors.

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1. Background

1.1 Valuation of land

Under the *Valuation of Land Act 1916* ("the Act"), the Valuer General is required to value all land in the state annually except for Crown Land and those parts of the Western Division that do not fall within the area of a rating or taxing authority. For the purposes of a general valuation, land is valued as at 1 July in the year the valuation is made.

Pursuant to section 6A(1) of the Act, land value is defined as follows:

The land value of land is the capital sum which the fee-simple of the land might be expected to realise if offered for sale on such reasonable terms and conditions as a bona-fide seller would require, assuming that the improvements, if any, thereon or appertaining thereto, other than land improvements, and made or acquired by the owner or the owner's predecessor in title had not been made.

Not only is the valuation made of the land component only of any property, but also the valuation is based on the assumption that the land may be used, or continue to be used for any purpose for which it is being used or could be used. That is, the basis of the valuation is the 'best use' that current zoning allows whether or not that is the actual use at the time of the valuation. The Act allows for a variety of allowances and apportionment factors in determining the value of land to take account of such things as heritage orders and other restrictions.

The Valuer General is also charged with keeping and maintaining a Register of Land Values. Local government authorities use the values for calculating local council rates entered into the register. The Valuer General issues valuation lists to each local government authority generally every three years for this purpose. Those authorities use the values for the calculation of rates in the following years until such time as a new valuation list is provided. Valuations appearing in local government rates notices therefore may or may not be the most current valuation issued for a particular property.

The Act requires the Valuer General to issue a Notice of Valuation to the landowner or any lessee or occupier liable to pay any rate or tax to a rating or taxing authority in respect of the land whenever he furnishes a valuation list to the council of a local government area. Those persons have a statutory right of objection to the valuation to the Valuer General. They also enjoy a further right of appeal to the Land and Environment Court if dissatisfied with the Valuer General's determination of the objection.

The Valuer General also provides the Office of State Revenue ("OSR") with annual valuation lists for the purposes of that authority assessing land tax under the *Land Tax Management Act 1956*. Persons issued with land tax assessment notices are advised in that notice of the latest land valuation upon which the land tax liability is calculated. The right of objection to a land valuation applies equally to a notice received in this manner as it does to a Notice of Valuation received directly from the Valuer General. It is only those persons liable for land tax therefore that are advised of the annual valuation of their land.

1.2 Contestable contracts for valuation of land

In 1996, in order to comply with the national competition policy reforms agreed by the Council of Australian Governments, the NSW government introduced legislation to enable the Valuer General to negotiate and enter into valuation service contracts for the provision of valuation services to the Valuer-General. Under the Act, as it now is, the Valuer General is able to regulate the manner in which those valuation services are carried out. Section 13A (2) provides that such contracts may contain provisions:

- (a) *setting out the principles and methods according to which the valuation services are to be carried out,*
- (b) *establishing performance indicators to assist with assessing the effectiveness and efficiency of the valuation services that have been carried out,*
- (c) *prescribing the qualifications of persons (including contract valuers and employees or agents of contract valuers) who may exercise specified functions,*
- (d) *identifying persons (including contract valuers and employees or agents of contract valuers) who may or may not exercise specified functions,*
- (e) *regulating the manner in which specified functions are to be exercised,*
- (f) *imposing restrictions on the exercise of specified functions,*

- (g) *authorising contract valuers to exercise functions or discretions that expressly or impliedly belong to the Valuer-General,*
- (h) *setting out the obligations of contract valuers to provide assistance to the Valuer-General in dealing with objections under Part 3, defending appeals under Part 4 and exercising functions under Part 5.*

The 1996 amendments allowed for two types of contracts –contestable contracts that were the subject of open tenders and uncontested contracts. The Act provided for the responsible Minister to issue orders to the Valuer General to invite tenders for valuation service contracts for the provision of valuation services in specified parts of the state, or for specified purposes or a combination of the two. Uncontested contracts had to be entered into with a newly created organisation, the State Valuation Office for all areas not covered by a Ministerial order or where there were no successful tenderers for areas covered by an order.

To facilitate this new regime, and using a regulator/provider rationale, the then Valuers General's Department was split into two organisations. The Valuer General's Department retained the policy, regulatory and contract management functions of the Valuer General. The State Valuation Office was created as a statutory office within the then Department of Land and Water Conservation to be the commercial entity that would enter contested and uncontested valuation services contracts with the Valuer General. The State Valuation Office has subsequently become a business unit within the now Department of Commerce and since 30 June 2003 has been called the Property Valuation Service¹.

Initially, four local government areas were ordered to be the subject of contestable contracts. In the following years, further areas became the subject of contestable contracts under a staged program. Since the 2004 valuation year, all areas of the state are now the subject of contestable valuation services contracts. Currently there are seven different private sector valuation firms providing valuation services under contestable contracts in addition to the Property Valuation Service. The Property Valuation Service holds the majority of contestable contracts. It is responsible for recommending the land values in approximately 70% of valuation districts.

Under section 13H of the Act, any valuation that emanates from a contestable contract (which now is all general valuations) must be made by the Valuer General on the recommendation of the contract valuer. Significantly, subsection (2)(b) of 13H further provides that the Valuer General may make the valuation without independently assessing the accuracy of the recommendation. The Valuer General is able to request a contract valuer to revise a recommendation but may only make a valuation himself in circumstances where no recommendation is made or the contract valuer fails to revise the valuation in accordance with the request.

What this means is that the vast majority of valuations are actually made by contract valuers and issued under the statutory authority of the Valuer General.

The 1996 amendments also introduced some new functions for the Valuer General to compliment his new role in the contestable market. These included requirements for the Valuer General to:

- monitor the standard of valuation services provided under valuation service contracts; and
- make assessments (on a sample basis or otherwise) of the compliance by contract valuers with procedural and other requirements of the Act, the regulations and the applicable valuation service contracts

In his second reading of the *Valuation of Land Further Amendment Bill 1966*, the then Minister for Land and Water Conservation, the Hon Kim Yeardon said the purpose of exposing the monopoly valuation activities of the Valuer General's Office to competition was designed to:

...promote efficiency in the delivery of valuation services and ensure that the required valuations are provided in a manner consistent with industry best practice at minimum cost.²

The Minister went on to say that cost savings achieved through competition would reduce the subsidy required from the Consolidated Fund to support the Valuer General and may be transferred in lower charges to local government and ultimately rate payers.

When read for the second time in the Legislative Council, further purposes of the amendment Bill were identified:

This amendment Bill clarifies the current confused role given to the Valuer General. It will remove the potential for conflicts of interest to arise. A provider of land valuation services will no longer regulate their provision. This separation will enable greater independence in the process of review and ruling upon objections to land valuations by members of the public³.

The initial call for tenders in 1996 also mentioned that the Government was seeking to achieve the additional objectives of:

- providing opportunities for the development of new mass valuation methodologies; and
- a high level of probity to support the continuing use of mass valuation as the tax base.⁴

1.3 Previous inquiries and continuing concerns

Due to their impact on land tax and council rates, land valuations have always been the subject of public interest and some controversy. In recent years there have been a number of government and Parliamentary inquiries commissioned into the land tax system and/or the valuation system. These include:

- *Report of the Government Treasury Advisory Committee, Land Tax Review*, June 1990.
- *White Paper on Land Tax: Review of the Land Tax Base and Valuation System*, February 1992
- NSW Government, *Tax Task Force, Tax Reform and NSW Economic Development, Review of the State Tax System*, August 1998
- Legislative Council General Purpose Standing Committee No 1, *Report on the Inquiry into Changes in Land Tax in New South Wales, July 1998* (the "Nile Inquiry")
- NSW Government, *Report of Inquiry into Operation of Valuation of Land Act*, Julie Walton, October 1999; and
- NSW Government, *Inquiry into Operation of Valuation of Land Act: Supplementary Report*, Julie Walton, June 2003

The most recent inquiries, the Nile Inquiry and the Walton inquiry, both concluded that a mass valuation methodology was necessary for the continuation of the annual valuation cycle⁵. Walton addressed a number of identified problems in the mass valuation system and recommended an intensive program of corrective action, various parts of which have since been implemented. These included that quality control measures be developed and that future contract specifications be drawn up with an emphasis on quality⁶.

In late 2001, the former Valuer General engaged Associate Professor John MacFarlane of the Property Research Centre at the University of Western Sydney in two separate consultancies to examine the valuation outcomes for 10 local government districts. The purpose was to propose suitable statistical techniques that might be applied to checking proposed statutory values, identifying appropriate criteria for selection of benchmark properties relative to the size and extent of homogeneity of component areas, developing methodologies for the control of the processes that lead to the identification of groups of properties as "components" that may be valued together under mass appraisal, advising on sampling methodologies that would enhance the control of the mass valuation process and reporting on trends in mass valuation methodologies⁷. A number of the recommendations made by MacFarlane were subsequently incorporated into the procedures followed by the Valuer General.

A volatile real estate market and changes to the land tax system have prompted public dissatisfaction with land values in more recent years. Sharp increases in median property prices have been experienced in many areas, particularly coastal areas, especially up to late 2003. In April 2004, the then NSW Treasurer delivered a Mini-Budget in which he announced significant changes to the land tax system for the 2005 land tax year. Previously NSW land tax had a tax-free threshold of \$317,000 and a rate of 1.7% after that. It was levied on owners of land in NSW as at midnight on 31 December of each year. Generally, the principal place of residence (except premium properties) or land used for primary production was exempt from land tax. Properties potentially liable for land tax therefore included: vacant land, investment properties, holiday homes, and commercial or industrial land. From 1 July 2004, the threshold was abolished and new lower tax rates were introduced, however, liability was generally extended to all properties other than the principal place of residence no matter what their value. This meant that approximately 400,000 additional property owners became liable for land tax for the first time. Increases in land valuations therefore became a critical issue of concern for those affected by land tax as it determined the amount of their liability.

1.4 The complaint

In early 2004, David Singer, of David Landa Stewart Lawyers, who specialises in commercial/business law and property law, lodged a complaint with the Ombudsman alleging maladministration against the Valuer General in relation to the determination of land values at base date 1 July 2003 in the valuation districts of Woollahra and Waverley and possibly other areas of NSW.

Mr Singer alleged the factors adopted by the Valuer General to determine land values in these areas were too high. He based this claim on an analysis of the increases in analysed adjusted land values assessed by the contractor for a range of sales properties used in the market analysis of those districts in both 2002 and 2003. He claimed these were consistently less than the adopted factor increases in the components those properties were a part of.

He also questioned the accuracy of the valuations made. He based this claim on an analysis of variations between the analysed land value determined by the contractor for these properties in 2003 and the value derived by application of the approved component factor which he assumed equated with the valuation issued by the Valuer General.

Mr Singer stated:

These are variations of quite massive proportions indicating a complete breakdown in the administration of the system of mass valuation employed by the Valuer General, such as would indicate that there has been a total loss of control by the Valuer General in administering the system and producing credible values. The system appears to have become totally corrupted and completely unreliable.

Since that initial complaint, Mr Singer has sent 36 further letters expanding on his criticisms of the land valuation system and provided a number of duplicate analyses of other valuation districts following his obtaining of a range of documents from the Valuer General through applications made under the *Freedom of Information Act*.

A preliminary investigation was conducted pursuant to section 13AA of the Ombudsman Act over several months by way of correspondence with the Valuer General and two meetings. These inquiries determined that some of the assumptions made about the issued valuations in the examples submitted with the original complaint were incorrect. However, after obtaining the correct values from the Register of Land Values (Valnet⁸), there still appeared to be some significant variations that *prima facie* warranted explanation. At the conclusion of that preliminary investigation I had not received an adequate explanation for such discrepancies and so decided to commence a formal investigation.

2. The investigation

The preliminary investigation had raised a number of questions about the administrative practices of the Valuer General and the staff of the Department of Lands that supported him in relation to the monitoring of the processes and outcomes of contracted valuation services. As a consequence of those inquiries, and the original complaint, I decided to use the Ombudsman's own motion power to focus the investigation on the quality assurance mechanisms employed by the Valuer General in his role of ensuring the integrity of valuations under the *Valuation of Land Act*.

The previous major inquiry into the land valuation system conducted by Walton in 1999 had placed a significant emphasis in its recommendations on the need to develop better quality control measures and incorporate a quality emphasis into valuation contracts. The investigation therefore performed a 'health check' to see how well those developments had been incorporated and were functioning based on a review of practices implemented during the 2004 valuation program.

2.1 Conduct the subject of investigation

On 3 November 2004, I issued notices of investigation to the Valuer General, the Director General of the Department of Lands and the complainant pursuant to section 16 of the *Ombudsman Act*. The conduct made the subject of investigation was:

- (i) The controls employed by the Valuer General to ensure the accuracy of valuations derived by the component method of mass valuation in valuation districts of New South Wales
- (ii) The handling of objections to valuations including the provision of information to potential and actual objectors.

2.2 The public authorities the subject of investigation

The subjects of investigation were specified in the notice of investigation as:

- (i) The Valuer General
- (ii) Such officers of the Department of Lands who provide assistance to the Valuer General in terms of the conduct the subject of investigation.

Mr Singer subsequently lodged further complaints requesting that I extend the investigation to cover the State Valuation Office. After giving careful consideration to this request, I declined to extend the investigation to this authority and advised Mr Singer of my reasons in a letter dated 8 March 2005:

Pursuant to section 13(4)(b)(iii) of the Ombudsman Act, I consider the subject matter of your complaint and the particular issues you allege to be wrong in terms of the SVO relate to the discharge by a public authority of a function which is substantially a trading or commercial function.

The valuation of land for the Valuer General is a contestable market and there are seven other private sector firms engaged in this work, one or more of whom you allege to be guilty of similar unprofessional conduct. None of those firms are able to be made the subject of investigation by the Ombudsman and on that basis I consider it would be unfair to single out the Property Valuation Service in this way.

More importantly, as I see it, the responsibility for overseeing the quality and accuracy of the valuations rests with the Valuer General and the officers of Land and Property Information who manage the contracts on his behalf. They are already the subject of investigation.

Mr Singer also made a number of submissions requesting the Ombudsman seek written undertakings and, if necessary, use the standing provision in section 21C of the Ombudsman Act to seek an injunction in the Supreme Court to restrain the Valuer General from issuing the 2004 land values. He also requested that we issue a warning to the Commissioner for State Revenue that he may be committing acts of maladministration if he relied upon the valuations provided to him by the Valuer General in issuing land tax assessments. Again, these requests were refused on the basis that such action would be precipitant, as at that stage the investigation had not established any wrong conduct.

Following the complainant's appearance on a morning radio program where he mentioned the investigation and some other media coverage, the Ombudsman received more than 160 further oral and written complaints from citizens objecting to what they considered to be unrealistic land values. Most of those complaints were about the individual valuation of specific properties and were declined on the basis that they had a statutory right of objection and appeal. A number, however, made criticisms of the valuation methodology used and/or the objection process and they have been considered as part of this wider investigation.

2.3 How the investigation was conducted

Formal requirements for the production of statements of information and production of documents were issued pursuant to section 18 of the Ombudsman Act on 3 November 2004, 24 December 2004, 4 February 2005, 24 February 2005, 11 March 2005, 16 March 2005, 21 March 2005, 14 April 2005 and 5 May 2005. The majority of these were directed at the Valuer General but Property Valuation Services were also required to produce certain documents and information on two occasions. Documents obtained from the Valuer General included various procedure manuals, market analysis and other reports produced by contractors for various valuation districts, district files maintained by contract managers, objection files and a range of statistical and other data reports.

The Valuer General and officers of Land & Property Information also co-operated in the provision of other information by way of email and face to face requests during the course of the investigation. For the purpose of accessing data from the Register of Land Values or examination of files, we made seven attendances on the office of the Valuer General or LPI.

In order to obtain a comprehensive view of the valuation program, it was decided to focus on a number of valuation districts. The areas chosen were the districts of Woollahra, Waverley, Kiama, Greater Taree, Hastings, and City of Sydney. The market analysis reports and associated data reports for all of these areas were studied in depth and the contract valuers and contract managers for those areas were formally interviewed. Particular focus was given to the residential components of these districts as they have the largest number of properties and are usually the source of the majority of objections and dissatisfaction with valuations.

In addition, to obtain a view on the general performance of the component system of mass valuation, the quality statistical measures reports were obtained for the 90 districts where they were currently required under contracts or were otherwise available. In addition to reviewing their contents, a verification exercise was conducted on a sample of these reports to check their integrity.

For the purpose of the investigation, it was decided to take sworn evidence from a sample of valuation contractors and contract managers in addition to the Valuer General, Philip Western, the Chief Valuer of the Department of Lands, Simon Gilkes and an expert witness, Associate Professor John MacFarlane. An inquiry using the Ombudsman's royal commission powers under section 19 of the Ombudsman Act was convened and sat on the following dates: 23-24 March 2005 in Sydney, 30 March 2005 in Wollongong, 31 March 2005 in Taree and Newcastle, 20 and 29 April 2005 in Sydney, and 2 May and 3 June 2005 in Sydney. The contract valuer and the corresponding contract manager for the following districts were examined: Woollahra/Waverley, Hasting/Greater Taree, Kiama and City of Sydney.

The investigation did not examine the accuracy of valuations of particular properties or classes of properties, only the general procedures and methodologies used.

I received full co-operation from all parties in the conduct of the investigation. In his evidence, the Valuer General captured this co-operation when he stated:

I certainly welcome your investigation and, I mean, I look forward to the recommendations you come up with in terms of how I can, you know, move the system forward and make it better for everyone, for all the stakeholders in New South Wales.

Pursuant to the natural justice provisions in the Ombudsman Act, on 8 July 2005 I issued a provisional report to the Valuer General and the Director General of the Department of Lands for the purpose of their making submissions. I received a submission from the Valuer General on 12 August 2005, which has been taken into consideration in the development of this report. The Valuer General informed me that he accepted each of the recommendations 6.1-6.34 set out later in this report that came within his responsibility⁹. He had already taken action to implement fourteen of the recommendations. The Director General of the Department of Lands requested I meet with Mr Des Mooney, the General Manager of LPI, and the Chief Valuer for the purpose of clarifying a procedural issue. This occurred on 16 August. They endorsed the submissions of the Valuer General and made no others.

On 19 August 2005 I provided the Minister for Lands, the Hon AB Kelly, with a draft report pursuant to section 25 of the Ombudsman Act. The Minister requested a consultation which was held on 19 September 2005. I have considered the Minister's comments in preparing this report.

3. An overview of the component method of mass valuation

The Valuation of Land Act does not specify the method by which land values are determined. Initially, the traditional method of comparison valuation¹⁰ involving a physical site inspection of each and every property was used but quickly became uneconomic and logistically impossible as the number of properties subject to taxing and rating increased. Gradually the use of traditional valuation methodology gave way to various forms of mass appraisal as computer based data processing became more widely available.

Since 1989, the Valuer General has used the component method of mass valuation.

Each local government valuation district is divided into components. Components are made up of properties that have similar characteristics where values are likely to move at similar rates in the real estate market over time. Properties within a component do not necessarily adjoin and may be scattered throughout a valuation district (a good example is a component consisting of motel sites). Each component groups properties of only one generic zone e.g. the properties are all zoned residential or commercial or rural etc. The main objective of component allocation is to include within a component properties that are expected to experience similar value movements.

Consequently, depending on the homogeneity of property types, the number of components varies from district to district. A small country district such as Conargo has 8 components whereas quite a few districts have more than 150. Components are subject to ongoing review and properties can be moved from one component to another at any time if necessary. This can be the result of a number of factors, for example, movements in the market where some properties become more desirable because of type or location which results in their value moving at a different rate than the rest of the component, or changes to statutory zones and planning policies within a local government area which affect potential use and therefore value.

Within each component, there are one or more benchmark properties selected by the contract valuers to establish the market movement between the valuation years. These are properties that are chosen because they are representative of the majority of properties within the component, or where there are multiple benchmarks, because they are representative of different value levels within the component or properties with some other emerging sub-component common characteristics that may affect value movement.

Contract valuers value these benchmarks at the 1 July base date using the traditional valuation methodology, most commonly the comparison method whereby sales of comparable vacant land or increasingly, sales of comparable improved land, are relied upon to estimate the land value of the benchmark. This valuation process is informed by the broad market analysis conducted by the contractor in which they analyse a range of sales transacted in the district. These sales analyses are carried out throughout the year and underlying land values deduced. The analysed land values are then adjusted for time to the 1 July base date once the general market movement has been identified before being relied upon to value the benchmark properties. The benchmark valuation is referenced to sales of some key properties that are most similar to the benchmark.

This benchmark value is divided by the issued valuation for the previous base date to produce a factor increase (or decrease).

Component factors are then determined based on the factors demonstrated by the benchmark properties. Where components have more than one benchmark property, the results between benchmarks are compared for consistency and representativeness. The component factor adopted is the factor that will adjust the largest proportion of properties within the component to their current market land value. To achieve this, consideration has to be given to the make up of the component so the component factor may be the same or slightly different to the benchmark factor. The overriding objective is to come up with a factor that will bring the majority of properties in the component up to the current market level.

The component factor therefore may not necessarily equate to the annual movement in the real estate market. If the previous values were below market level for example, this would mean component factors greater than the annual movement in the real estate market to make up the difference.

Once determined, the component factor is applied to the previous valuation of all the properties in the component. However, each value must be capable of being supported by market evidence so the contract valuer reviews the values produced by application of the component factor to verify them. Where necessary, individual values within the component will be adjusted to give a result closer to the market value. The general verification process can range from a desk audit of resultant values up to a physical inspection of individual properties and the use of traditional valuation methodologies.

Some types of properties are so few in number or likely to be so sensitive to localised changes that handcrafting values by means of a physical inspection of the property is the only appropriate method. The term “handcrafting “ is generally applied to values that are individually determined or are made using the component methodology and then verified by inspection. The degree of handcrafting varies from district to district and component to component and is largely a product of the degree of homogeneity in components. Small components such as the majority of commercial and industrial components and certain types of residential components such as those comprising waterfront properties tend to have a higher degree of handcrafting than others. In some districts certain components or types of properties are always handcrafted (eg. all waterfront properties in Woollahra and Waverley).

4. Quality assurance measures employed by the Valuer General

4.1 Contracts for valuation services

Clearly a major objective of the move to contestable contracts was the lowering of the cost of valuation services. This has been born out in the intervening years. For example, the cost per valuation provided to the Office of State Revenue was reported in 1997-98 as being \$4.59¹¹ which, adjusted for inflation, was equivalent to \$5.49 in the June quarter of 2004¹². Despite the general increase in costs of wages, office accommodation and so on in the intervening six years, the equivalent cost per valuation to OSR in 2003-2004 was actually less in real terms – only \$5.06¹³.

The net cost of valuations to the Valuer General from valuation service contracts varies across the districts. Costs are impacted by factors such as the homogeneity of property types, travel needs, and the complexity of valuation calculations. The competition for contracts is obviously another factor that affects prices. According to the Chief Valuer, Simon Gilkes, there is quite a vigorous market for the services in the metropolitan area but the market is much more patchy outside, particularly in the western parts of the state.

The raw valuation costs for current contract areas (excluding the Valuer General's and LPI's on costs associated with contract and objection management) appear in Table 1 below. It shows that in highly homogenous metropolitan areas like Blacktown, which have relatively few components (43), the cost per valuation is as low as \$1.77. Costs increase as districts become less homogenous and the need for handcrafting rises (for example \$4.83 in the Eastern suburbs), or where country travel becomes a significant factor (for example Muswellbrook \$7.22 and New England \$9.15) and where the absence of vacant land sales means the analysis of sales of improved properties becomes more necessary and complex (for example, \$13.05 in the City of Sydney).

Table 1. Cost per valuation under current valuation contracts¹⁴

Valuation Area / Contract period	Contractor	Total cost of contract (including GST)	Number of valuations (2004)	Average cost per valuation
Blacktown 1/5/05-30/4/08	Crown Valuation Service	\$891,000	167,659	\$1.77
Outer Hunter 1/5/03-30/4/06	Prince Harrington	\$434,500	72,902	\$1.99
Parramatta 1/5/04-30/4/07	Crown Valuation Services	\$891,000	132,154	\$2.25
Newcastle 1/5/05-30/4/08	Dupont Valuers	\$874,500	129,398	\$2.25
Central Coast 1/5/05-30/4/08	Robertson & Robertson	\$825,000	120,252	\$2.29
Canterbury/ Bankstown 1/5/03-30/4/06	Property Valuation Service	\$633,600	84,320	\$2.50
Penrith 1/5/03-30/4/06	Property Valuation Service	\$907,500	116,360	\$2.59
St George/ Sutherland 1/5/03-30/4/06	Southern Alliance Valuation Services Pty Ltd	\$935,000	119,296	\$2.61

Valuation Area / Contract period	Contractor	Total cost of contract (including GST)	Number of valuations (2004)	Average cost per valuation
Wollongong 1/5/05-30/4/08	Crown Valuation Service	\$744,700	86,886	\$2.86
Warringah 1/5/03-30/4/06	Property Valuation Service	\$495,000	57,209	\$2.88
South Coast 1/5/03-30/4/07	State Valuation Office	\$770,000	62,083	\$3.10
Burwood 1/5/04-30/4/07	Quotable Value Australia Pty Ltd	\$858,000	87,602	\$3.26
Campbelltown 1/5/04-30/4/07	Quotable Value Australia Pty Ltd	\$1,122,000	113,961	\$3.28
North Harbour 1/5/03-30/4/06	Property Valuation Service	\$660,600	51,863	\$4.24
Taree 1/5/03-30/4/07	Property Valuation Service	\$1,430,000	79,624	\$4.49
Upper Nth Sydney 1/5/03-30/4/06	Property Valuation Service	\$616,600	45,724	\$4.50
Sydney East 1/5/04-30/4/07	Crown Valuation Services	\$891,000	61,530	\$4.83
Lismore 1/5/02-30/4/06	Sydney Valuers	\$1,474,000	70,299	\$5.24
Tamworth 1/5/02-30/4/06	Property Valuation Service	\$116,720	49,155	\$5.68
Byron/Tweed 1/5/04-30/4/08	Property Valuation Service	\$936,100	40,575	\$5.77
Orange 1/5/02-30/4/06	Property Valuation Service	\$932,800	39,925	\$5.84
Goulburn 1/5/02-30/4/06	Property Valuation Service	\$842,600	33,589	\$6.27
Griffith 1/5/03-30/4/07	Property Valuation Service	\$660,000	23,856	\$6.92
Albury 1/5/05-30/4/08	Quotable Value Australia Pty Ltd	\$940,500	45,175	\$6.94
Wagga 1/5/04-30/4/08	Property Valuation Service	\$1,006,500	35,832	\$7.02
Deniliquin 1/5/03-30/4/07	Property Valuation Service	\$616,000	21,406	\$7.19
Muswellbrook 1/5/04-30/4/08	Property Valuation Service	\$658,900	22,804	\$7.22
Queanbeyan 1/5/03-30/4/07	Property Valuation Service	\$770,000	23,868	\$7.28
Wollondilly 1/5/04-30/4/07	Property Valuation Service	\$839,667	36,122	\$7.75
Nyngan 1/5/02-30/4/06	Property Valuation Service	\$1,577,510	48,379	\$8.15

Valuation Area / Contract period	Contractor	Total cost of contract (including GST)	Number of valuations (2004)	Average cost per valuation
Coffs Harbour 1/5/05-30/4/08	Property Valuation Service	\$1,309,660	51,904	\$8.41
Bega 1/5/05-30/4/08	Property Valuation Service	\$1,066,560	41,681	\$8.53
Bathurst 1/5/04-30/4/08	Property Valuation Service	\$987,800	27,146	\$9.10
New England 1/5/05-30/4/08	Property Valuation Service	\$932,580	33,974	\$9.15
Dubbo 1/5/05-30/4/08	Aspect Property Consultants	\$1,076,130	37,370	\$9.60
Sydney City 1/5/04-30/4/07	Quotable Value Australia Pty Ltd	\$1,072,500	27,389	\$13.05

As the average cost per valuation in the above contracts shows, you are not buying much of a valuer's time for a valuation produced by the component method of mass valuation. The vast majority of properties do not in fact get any individual attention at all. Apart from those handcrafted or re-assessed during the objection process, the majority of properties are simply indexed by component factors.

As mentioned in 1.3 above, the Walton review recommended that a quality emphasis be incorporated into the contracts for valuation services. Some development has taken place to address this.

It appears that in the earlier years of contestable contracts, price played a more major role in terms of selection weighting in contract evaluation. According to the current Valuer General, over time this started to impact negatively on the quality of valuations produced:

...a key part of the whole tender process which I changed when I took office [was] to ensure that we started to bring some more emphasis in terms of quality of valuation as opposed to price, and I'll be candid with you, the reason for that was that, in my opinion, the price had got to a stage where it was starting to impact quite heavily upon the quality of the valuations which were being obtained from contractors. So, with that in mind, I fundamentally changed the tender process in terms of what was expected as far as the weightings for the various components of the tender

In the last round of tenders in 2004, price was given a one third weighting compared to quality criteria, which had a two third weighting in the overall evaluation process. According to the Chief Valuer, short listed tenders were evaluated against seven or eight quality criteria. Three in particular were weighted more heavily than others – the staffing plan (the combination of skills and experience as well as having an adequate number of staff to carry out the task), the methodology proposed (the demonstration by the contractor of their understanding and knowledge of the methodology and the robustness of the proposed methodology) and the contract management plan.

For the purposes of the investigation, a sample contract for each of the existing eight contracting firms was examined. The current contracts contain a standard set of conditions including a range of conditions such as payment schedules, indemnity, default and termination clauses and the like that are commonly found in commercial contracts. However, a number of the conditions address quality issues.

Firstly, the contractor is obliged to agree to co-operate with the Valuer General to ensure the services are provided in accordance with the contract in a manner designed to achieve the objectives of the Valuer General which are stated as:

- (a) *the competitive and commercial supply of valuations to the public including lowering the cost of services to end users;*
- (b) *to make accurate and complete valuations; and*
- (c) *a high level of probity and quality control to support the continuing use of mass valuation as a tax base of the New South Wales Government.*

Secondly, the contract places a number of obligations upon the contractor. These include:

- maintaining appropriate facilities, staff and other resources to perform their obligations;
- providing the services diligently, efficiently and professionally to the standard of care and skill of a person experienced in the provision of valuation services;
- ensuring that all staff engaged in the provision of the services are suitably qualified and experienced and act with appropriate skills and ability in accordance with acceptable professional standards;
- at least one of the contracting staff at all times being a practising real estate valuer within the meaning of the *Valuer Registration Act 1975*;
- complying with the provisions of the procedures manual and otherwise following all orders and instructions of the Valuer General in respect of performance by the contractor of its obligations pursuant to the contract;
- acting lawfully and in good faith to the Valuer General and at all times upholding and enhancing the reputation of the Valuer General and the New South Wales Government;
- furnishing to the Valuer General upon request such reports as he reasonably requires;
- immediately notifying the Valuer General of any circumstance which has or is likely to affect the contractors ability to perform its obligations and the proposed steps to be taken to remedy this circumstance;
- using any facilities or equipment provided by the Valuer General appropriately and efficiently;
- keeping complete true and accurate records in such detail and format as the Valuer General may reasonably require from time to time relating to the provision of the service, retaining such records for seven years, and allowing the Valuer General on reasonable notice to examine and make copies of any or all such records;
- using all reasonable endeavours to inform itself and to keep informed of the requirements of the Valuer General;
- taking action to rectify any situation including replacing any staff member when the Valuer General is of the reasonable opinion that any representative of the contractor is not providing the services in a satisfactory manner
- avoiding any actual or potential conflict of interests arising in relation to the provision of the service and promptly notifying the Valuer General and complying with his directions in relation to such;
- allowing the Valuer General or his representatives access to the contractor's premises upon reasonable notice and permitting them to inspect the premises and interview the contractors staff in relation to the provision of the services including providing access to the systems (computer or otherwise) used by the contractor to perform the services for the purposes of reviewing compliance with the terms of the contract and to assess the quality of such systems;
- complying with statutory obligations including specifically to provide valuation recommendations and supplementary valuations which comply with the requirements of the Valuation of Land Act and any other applicable law;
- being responsible for and paying for any extra costs occasioned by any discrepancies, errors or omissions in data, documentation or other information supplied in writing;
- meeting regularly with the contract manager especially during the period May to October;
- providing progress reports and where stipulated, a performance scorecard;
- developing in consultation and agreement with the contract manager a service delivery schedule and a detailed programme based on specific requirements of the individual districts comprising the contract;
- updating the program monthly and recording progress against the baseline program, and working with the contract manager to revise the programme to cater for changing circumstances, identifying slippages and developing strategies to ensure accurate and timely satisfaction of contract requirements.

The standard contract provides a number of conditions relating to confidentiality and contains a confidentiality acknowledgement as one of its schedules. In three of eight contracts examined, this schedule was not endorsed.

The contract further requires that the services shall be provided in accordance with the quality assurance guidelines laid down in the procedures manual.

Performance monitoring is specifically addressed in the contract although only in terms of flagging that the quality control process will require implementation of a number of statistical tests designed to measure the accuracy and quality of recommended valuations and that the contractor is required to co-operate with any reasonable requests made by the Valuer General in relation to reviews of matters such as the number of benchmarks, the identification of components, and the degree of handcrafting.

The principal quality feature of the standard contract conditions is the requirement to comply with the Procedures Manual and the quality assurance guidelines contained within it.

The service as defined in the contract consists of the provision of:

- coding services –which comprise the updating of the property information held by the Valuer General in the Valnet register;
- market analysis and benchmarking services –which involves the provision of a preliminary report, a component factor report, a market analysis report (which can include the preliminary and component factor reports if provided before their due dates), a valuation analysis report and a final report for those districts to be issued for local government rating, including a draft press release. These are all to be in the format and contain information specified in the Procedures Manual;
- valuation recommendation services –which comprises the upload files of recommended new values for all properties in the district;
- objections and appeals services-which involves the provision of records or information required by the Valuer General for determining any objections or enquiry raised by a third party and preparing reports and providing expert evidence in any proceedings in relation to a valuation based upon the contractor's valuation recommendation; and
- progress reporting.

The contract requires these services to be provided using the approved methodology (see 4.2 below) to “provide accurate and complete valuation recommendations to enable the Valuer General to make accurate valuations”.

4.2 Approval of contractor methodologies

The standard contracts contain a schedule that sets out the methodology to be used. The contract requires the market analysis services, benchmarking services, objections and appeals services and the valuation recommendation services to be provided using the approved methodology. Methodology is defined in the contract as:

The method of making a valuation or a valuation recommendation as set out in schedule 5 and, if not so set out, is the component method of valuing property whereby properties to be valued are attributed to components and the valuation of properties with [in] the same component are varied by the same proportion or amount (as the case may be) unless otherwise determined by the party performing the valuation or valuation recommendation and at all times such methods will be formulated in accordance with this contract

Acceptance of a tender involves the Valuer General accepting the proposed methodology of the contracting firm. The practice is to extract the proposed methodology from the tender and incorporate that into the contract as a schedule.

As previously mentioned, for the purposes of the investigation, we examined a sample contract for each of the current eight valuation contractors.

The contracts for Property Valuation Services, Quotable Value Australia and Crown Valuation Service contain fairly extensive descriptions of their methodologies, each of which provides for a secondary or re-factoring capacity following application of the primary component factor for ranges of properties. The contracts for the other contracting firms are relatively concise and indicate that the methodology to be used is the component valuation methodology currently used or prescribed by the Valuer General.

Essentially, all the firms use a basically common approach that is recognised and outlined in the Valuer General's *Procedure Manual for Contract Valuers*.

While the initial tender for contestable contracts in 1996 stated one of its aims as “providing opportunities for the development of new mass valuation methodologies”, according to the Valuer General, innovation has only happened “around the edges”.

The fundamental requirement of mass valuations is that each individual valuation must be supportable using traditional valuation techniques and market evidence. This is essential to meet statutory requirements and to provide justifiable valuations that will support the continuing use of mass valuation as a tax base.

4.3 The service level agreement with Land & Property Information

The Valuer General only has a small staff reporting directly to him – 1.6 effective full time employees. The vast majority of support work to carry out his responsibilities is contracted out to Land and Property Information NSW (“LPI”). As a government business enterprise division of the Department of Lands, LPI is the main information broker in the state relating to registers of land and property information. It provides services to the Registrar General and Surveyor General in addition to the Valuer General.

The Valuer General develops a service level agreement with LPI each year that runs on a financial year basis. It defines the services and performance levels that LPI is required to deliver to the Valuer General. A formal instrument of delegation enables appropriate positions within LPI to carry out specific functions of the Valuer General, although the Valuer General retains the financial delegations for the payment of valuation service contracts. LPI collects and retains all valuation revenues from the provision of statutory valuation and other services and meets all costs associated with the provision of services covered by the agreement. Progress against key performance indicators is reported on a monthly basis to the Valuer General.

The principal service outputs covered by the current service level agreement are:

- Maintenance of the register of land values –which includes updating the register with new/amended values and data relating to property characteristics including applicable allowances and concessions;
- Issuing valuation lists and notices of valuation;
- Determining objections against valuations and managing the objection and appeal process.
- Managing the mass valuation contracts in accordance with contracts, procedure manuals and instructions;
- Managing and conducting other valuation services –which relates to special purpose valuations and determining compensation in accordance with the *Land Acquisition (Just Terms Compensation) Act*;
- Customer service provision-which includes provision of services to respond to valuation enquiries, providing information to respond to Ministerial replies and preparation of briefing papers and advice on contentious matters relating to valuation issues;
- Managing external communication with key customers such as OSR and local government authorities;
- Providing and maintaining information systems for valuation data; and
- Providing reporting services to the Valuer General.

The Valuer General introduced key performance indicators (“KPIs”) into the 2004 agreement for each of the specific in scope responsibilities falling under each of the general service functions listed above. These generally set specific dates for the provision of service, set expected turnaround times, and specify expected percentage compliance with quality assurance standards. Where applicable, LPIs performance against KPIs in the service level agreement and the appropriateness of certain KPIs are addressed in the sections that follow.

4.4 Procedure manuals

4.4.1 Procedure Manual for Contract Valuers

Since the introduction of contestable valuation contracts, there has always been a procedures manual issued to contract valuers. The first version was made up of whatever bits of instruction were then existing in the Valuer General's Department and it has been progressively refined over the intervening years. There was a significant change of detail and procedures incorporated into the revision issued in May 2003 that was titled *Mass Valuation Procedures Manual for Contract Valuers*. This 24 page manual (plus ten appendices) explained the Valuer General's mass valuation system and the reporting and approval requirements of the valuation contracts for contract valuers that applied to the 2003 valuation program. All parts of the manual applied to all contractors except for the newly introduced quality assurance statistical checks relating to coefficient of dispersal, mean value price ratio and price related differential (see 4.6.7 below). Contractors were encouraged to provide these but they were not included in the contract assessment process for the contracts that had been issued in previous years.

Following his appointment in October 2003, the Chief Valuer Simon Gilkes oversaw a revision of the manual and introduced version control. For the 2004 program, version 3.1 of the now titled *Procedures Manual for Contract Valuers* came into effect. While the revisions were relatively minor (the core manual grew by 3 pages plus some expanded appendices, particularly the appendix outlining the statistical controls), it was re-organised and took on a more professional and user friendly lay out. In terms of quality, the revised manual did, however, introduce some new initiatives.

Firstly, it specified that when conducting valuations, contract valuers were required to comply with the Australian Property Institutes standards, PS1-Valuation Procedures and GN5.1 –Valuation for Rating and Taxing. These standards were developed by the Australian Valuation and Property Standards Board, the National Professional Board of the Australian Property Institute and the New Zealand Valuation and Property Standards Board of the New Zealand Property Institute. They are heavily influenced and largely consistent with the professional practice standards of the International Valuation Standards Committee, the peak international standards body for the valuation profession.¹⁵

Secondly, it introduced requirements for meetings with contract managers to establish dates for deliverables and a monthly progress reporting regime from May to October and in January and April.

Thirdly it implemented a revised statistical standard for the mean value price ratio (85-100% from 85-110%) following the Valuer General's tightening of the acceptable margin of error so that acceptable valuations could not be higher than the market level.

Fourthly, it introduced an expanded dictionary of terms to tighten control on interpretation of the manual's procedures including a revised definition of handcrafting. In the 2003 manual handcrafting was defined as "Handcrafted values means valuations that are individually determined by the valuer following a physical inspection of the property." In the 2004 version 3.1 manual, the definition of handcrafted valuation "means a valuation recommendation made using the Methodology which has been verified by inspection"¹⁶.

Both versions of the manual notably acknowledge the limitations of the mass valuation methodology:

The use of mass valuation techniques does have limitations, particularly over a period of time. The continued application of factors may lead to a distortion in the relativity of values within a geographical area. Some types of properties are so few in number or likely to be so sensitive to localised changes that handcrafting values is the only appropriate method.

Contract valuers are responsible for selecting and advising the most appropriate method of valuation.

Although a mass valuation system is used to determine the majority of land values, the Valuation of Land Act requires that each land value must be capable of being supported on its own by the market evidence. This is particularly relevant if a valuation is objected to or challenged in court¹⁷.

Where applicable, the relevant procedures and standards contained in the *Procedure Manual for Contract Valuers* are detailed in the sections that follow that discuss the different phases of the mass valuation process.

4.4.2 Rating & Taxing Valuation Contract Management Procedures Manual

In July 2003 a draft *Mass Valuation Procedures Manual for Contract Managers* was developed to assist the district valuers who were given responsibility within LPI for managing the valuation services contracts. It is unclear how widely distributed this was or how fully used it was. Its ten pages (plus some appended forms and guidance notes) provided only the barest of instructions.

Following the appointment of the new Chief Valuer and Valuer General in late 2003, the manual was substantially revised for the 2004 valuation program and version 1 of the *Rating & Taxing Valuation Contract Management* was issued on 30 June 2004 and applied to the 2004 valuation program. The manual fleshed out the bare process steps outlined in its predecessor and gave more detailed guidance on specific tasks that were required of contract managers in relation to those steps.

The manual also set out some contract management principles, which encapsulated the philosophical approach the new Valuer General wanted to underlie the relationship between contract valuers and contract managers.

Firstly it stated the objective of the contract management process was to "provide an environment conducive to compliance as opposed to seeking to identify and punishing non-compliance" and emphasised that it was based on the concepts of "partnership, transparency, consistency of process and creating positive outcomes".

In terms of the partnership principle, the manual states that "reciprocity and collaboration between contractors and contract managers" is required and that the contract management process encourages shared goals and recognises the relationship as being mutually beneficial.

The manual requires that the process of contract management be properly documented to facilitate co-operation and ensure the process will withstand scrutiny. It further requires its procedures to be followed by all contract managers to ensure a uniform approach so that there is consistency of process across the contracts. Finally, it encourages contract managers to focus on the end results throughout the process to ensure the best results [meaning accurate and complete valuations] are delivered.

In addition to establishing standards and tasks associated with the monitoring of the annual valuation procedures, the manual established a procedure for non-compliance, monthly compliance certification for regular contractual payments and a quarterly review of each contract area by Regional Valuers that address quality control, verification of data, consistency, contract management and conformance to procedures.

LPIs compliance with the contract management tasks and standards are addressed in the sections below.

4.5 Monitoring of process

4.5.1 Contract management

Contract managers are responsible for monitoring the actual performance of the contract in relation to the planned or desired service as outlined in the contract and the *Procedures Manual for Contract Valuers*. They perform that role guided by the procedures outlined in the *Rating & Taxing Valuation Contract Management*.

In assessing how well that role is being done it is useful to have regard to best practice frameworks for contract management. I have used as a benchmark the Australian Audit Office guide *Contract Management Better Practice Guide*, February 2001. According to that guide, best practice performance measurement systems for contract management suggest that a monitoring framework should display the following elements¹⁸ (an assessment of compliance is outlined under each element):

- A commercial contract defining the commercial and business relationship
This criterion is satisfied by the standard conditions set out in the contracts for valuation services issued by the Valuer General.
- A procedural manual containing instructions on how to perform the services.
This criterion is satisfied by the provision of the Procedure Manual for Contract Valuers which is kept under continual review by LPI staff.
- A service level agreement detailing the standards for each service.
Standards expected of contractors are incorporated into the *Procedure Manual for Contract Valuers* or cross-referenced to standards specified in the contract sufficient to satisfy this criterion. Contract managers are also guided by key performance indicators that are set out in the service level agreement between the Valuer General and LPI.
- Appropriate and effective methods for measuring and monitoring performance.
It appears that a specific means for measuring and monitoring performance of contractors has only recently been introduced with the 2004 *Rating & Taxing Valuation Contract Management Procedures Manual*, in particular the use from the start of the 2004 valuation program of program control forms, monthly compliance certification and the introduction of statistical measures to assess the quality of valuation outcomes. It is acknowledged, however, that in preceding years various data tables were provided by contractors and monitored by contract managers supplemented by their running various data integrity and other reporting checks on value quality.
- Targets aimed at continuous improvement.
There are no specific targets incorporated into contracts, procedure manuals or the service level agreement that address continuous improvement. The closest expectations articulated are statements requiring contractors to keep the composition of components and selection of benchmarks under continual review. There are no means of measuring the effectiveness of those processes, however, apart from the subjective judgement of the contract manager of the adequacy of the action taken.
- Components to measure continuous improvement.
Given the Valuer General has a specific statutory obligation to monitor the standard of valuation services provided under valuation service contracts and to make assessments of compliance by contract valuers with procedural and other requirements of the Act, regulation and the contract, it is notable that there are no current performance measurement systems that monitor the outputs of contractors or the levels of accuracy and completeness of the valuation recommendations they make over the program years of their contracts. Both the Valuer General and the Chief Valuer in their evidence, for example, expressed an expectation that compliance with the newly introduced statistical standards would improve over time. However, there appears to be no systems currently established that would monitor these year to year to assess improvement at the district level.
- Timely problem solving.
The procedures for non-compliance set out in the *Rating & Taxing Valuation Contract Management Procedures Manual* provide a satisfactory framework for meeting this criterion. Inspection of district files and evidence taken from both contractors and contract managers reveal that there is generally responsive communication from both sides in relation to any identified delays or problems with data.
- Reporting documents that, through graphical, pictorial and/or descriptive means, demonstrate adequately the achievements of the service levels in the contract and the service level agreement

There appears to be sufficient data reporting from contractors or available from the Valnet system from which their performance could be adequately monitored. There is however, a deficit in respect of overviews of contract performance and valuation outcomes on a whole of valuation program basis.

While the contract itself, the standards incorporated into the procedures manual and the systems developed for monitoring performance provide the general framework for the management of the valuation services contracts, the Australian Audit Office Best Practice Guideline suggests successful day to day management of the contracts is also dependent upon a number of key considerations¹⁹ including:

- The contract managers having the full support of senior management and the resources to do the job.
While both the Valuer General and the Chief Valuer appear to be fully supportive of the contract managers, there is clearly a problem with the level of material support for the contract management process. LPI currently has insufficient district valuers to properly cover the contract management duties in respect to all existing contracts and is forced to involve most if not all Regional Valuers in direct contract management as well. This has meant that they do not have adequate separation from the contract management process to enable them to perform the quarterly audits and reviews of the contract management process specified in the *Rating & Taxing Valuation Contract Management Procedures Manual* to ensure consistency in contract management across their regions. The investigation reviewed a sample of district files and contract files and found no evidence of these quarterly audits or any other review of the performance of contract managers and their compliance with the specifications in the procedures manual. Our audit of a sample of district and contract files found compliance with contract management procedures generally wanting (see below)²⁰.
- The manager being familiar with the activity and the process from which the contract arose.
This criterion appears to be well satisfied. Many if not all contract managers, certainly the sample interviewed as part of the investigation, were highly experienced valuers most of whom were former staff members of the old Valuer General's Department or the State Valuation Office and thus had first hand experience of undertaking component mass valuations themselves.
- The manager having the requisite skills or being trained in contract management and any specialist skills required.
While the contract managers appear to all have the requisite specialist skills in terms of understanding the process of component based mass valuation, a number of the more recent appointments to senior valuing positions have not been provided with specific training in contract management²¹. Nor had the contract managers received any training prior to June 2005 in the application and interpretation of the new quality statistical measures. This undermined the effectiveness of these quality assurance measures in both the 2003 and 2004 valuation programs, as the significance of non-compliance was poorly understood (see 4.6.7 below).
- The manager having sufficient authority for day-to-day management.
The valuation service contracts require contractors to follow the directions of the Valuer General and contract managers are delegated with these powers. Our inspection of district files revealed the issuing of regular queries and instructions. The contract managers are also in a position to certify compliance of contractors on a monthly basis and are able to recommend the withholding of contract payments. There was evidence of payments being withheld to verify that this was a power exercised where necessary. This is sufficient to satisfy this criterion.
- The organisation having a relationship of trust with the provider.
The investigation found a high level of respect for the expertise and local knowledge of contract valuers among contract managers. Many contract valuers are former employees of the Valuer General's Department. While many contract valuers may not have themselves been former working colleagues of the contractors they monitor, the fact that they have had similar training and experience provides a solid basis for mutual professional respect.
- A flexible attitude being taken to contract management; and the contract management team learning as it goes, to improve continuously the possibility of a successful contract.
The contract management principles outlined in the *Rating & Taxing Valuation Contract Management Procedures Manual* are indicative of the attitudes and relationships between contract managers and contractors that were observed during the course of the investigation. There is clear evidence in terms of the revisions to the procedure manuals and the introduction of workshops and training in recent months involving both contractors and contract managers that the Valuer General and the Chief Valuer are endeavouring to foster a collaborative partnership approach to valuation services contracts and through the better articulation of expectations, clarification of roles, and introduction of rigour through implementation of qualitative quality assurance measures, are working to continually improve the accuracy of valuation outcomes.

The valuation services contracts are for the provision of a professional service with outputs that are not necessarily conducive to precise measurement. This provides a number of challenges for contract management. The Chief Valuer characterised the challenge in the following way:

...one of the difficulties in managing this type of contract is that much of the service is comparatively intangible –you know, its not like buying something off a factory floor for example, where it either fits the specifications or it doesn't. Valuation naturally, because it operates firstly in a subjective market, and an imperfect market at that, there will always be an element of opinion in valuation and some degree of subjectivity. So consequently, it is not well suited to managing these sorts of contracts in a black letter law kind of way if you take my meaning. Consequently, certainly my view, and I think Philip Weston's view, is that the best way that we can optimize the quality in the process is to have both contractors and contract manager's essentially working on the same side to achieve the same goals rather than, if you like, being in conflict. I think that that's the basis of the concept, if you like. In that way the role of the contract manager is more one of coach and adviser, if you like, rather than manager as such.

Having said all that, I still recognize that these are contracts of substantial value and so it is always necessary and I believe it's always fully understood, that at the bottom line there is actually a contract in place that needs to be complied with...

For the purpose of gauging compliance with the Rating and Taxing Valuation Contract Management Procedures Manual we audited a sample of eleven district files against the requirements laid out in the manual. It appears that contract managers are not always fulfilling the expectations as set out in the manual. For example, based on the copies of files provided to us by the Valuer General or ones we inspected on site, we noted the following:

- a) Program control forms were found on only five of the eleven hard copy files.
- b) Four files had no minutes of meetings with contractors.
- c) Eight files had none or only a few of the monthly progress reports.
- d) Six had none or only some of the monthly contractor compliance scorecards.
- e) Two had no component check forms or evidence of any alternative narrative form of component checks.
- f) Two had no evidence of correspondence with the contractor following component report checks.
- g) Two had no records of the data integrity checks undertaken.
- h) Only two of the ten files where the district had non-conforming statistical results had a written record of an explanation from the contractor.
- i) None of the files had evidence of the Regional Valuers three monthly audit.

It is likely that some of these tasks were actually completed by the contract managers responsible for the district files in the audit sample but records otherwise filed or simply not made. For example, contract payments are dependent upon certification by way of the monthly compliance reports so its probable that they were produced but have been filed elsewhere. In other areas, such as the quarterly audit reviews of the contract management process by Regional Valuers, there is a clear recognition that this quality control procedure is not being complied with due to insufficient resources. The absence of evidence of other tasks critical to the contract management process, such as completed program control forms, however, is worrying. Part of the problem in auditing activity is that the 'official' records comprise a combination of part hard copy files, electronic download files, plus emails often retained in personal directories which are not always collated together.

What our audit clearly demonstrated is that, with some individual exceptions, record keeping by contract managers on the whole is extremely poor. When asked to comment upon this, the Chief Valuer said:

...in my view that is essentially not satisfactory. The procedures manual as it is, whether it's the right set of procedures or not, my view is that that's the procedure that's been set down and should be followed until there's some agreement or some change to that manual to say that we should be doing something else. As I said and flagged, one of the things that should be done in our internal audit program was an audit of exactly these sorts of things to focus attention of the contract managers that this is actually serious and they are things that need to be done.

4.5.2 Verification process for market analysis and approval of benchmark valuations and component factors

4.5.2.1 Market Analysis Reports

Following submission of the Preliminary Report, which briefly outlines the steps and investigations contract valuers are taking to commence the valuation program, the two most important deliverables of contract valuers are the Market Analysis Report ("MAR") and the Component Valuation Report which forms part of it.

The Preliminary Report is generally due no later than 1 August followed by the Market Analysis Report due no later than the end of the second week of October²². The preliminary report can be included in the MAR if it is provided before their due dates.

The main features of the MAR are the textual overview of the analysis of sales used in establishing market level valuations and the provision of the detailed analysis of each individual sale analysed.

A partly confusing aspect of record keeping is that all three reports tend to be put together and collectively referred to as the Market Analysis Report. The complainant obtained copies of a number of MARs by way of applications under the *Freedom of Information Act* and was provided with documents in each case titled for example 'Market Analysis Report for X District' which consisted of the preliminary report, component factor report, component valuation report (titled 'benchmark valuation reports' by some contractors) the market analysis report and the individual sales analysis reports. During the investigation we were similarly provided with these 'collective' versions of MARs even though technically the MAR refers to what in most cases is a relatively small text document outlining the general market movement in the district.

The contract actually uses this collective notion of the MAR wherein it provides that the Valuer General may adopt the Benchmark Valuation Recommendations "contained in the Market Analysis Report" or make such amendments as he sees fit and adopt such Market Analysis Report. It goes on to say "The Market Analysis Report in the form adopted by the Valuer General thereafter is required to be utilised by the parties in the performance of their obligations".

There are two issues that arise from this. The first is whether there is in fact a practice of the Valuer General producing and adopting an amended MAR and the second is the nature of any such final document.

There in fact does not appear to be any process by which a market analysis report is formally adopted. Rather the approval process is confined to the adoption of the contractor's proposed component factors.

The investigation came across no case where the Valuer General adopted a set of benchmark valuation recommendations that were different to those ultimately put forward by the contractor or amended an MAR in any way. We found many examples where contract managers had questioned contractors about the adequacy of the sales analysis relating to particular benchmark valuations or the suggested component factors. In some cases these resulted in additional sales analysis being undertaken by the contractor and revised valuations and factors being put forward. In other cases, the contractor provided adequate explanations to justify their initial recommendations and those recommendations were subsequently accepted by the contract manager. However, it appears that the reserve powers of the Valuer General to amend recommendations as he sees fit are rarely if ever used. Rather, any concerns over the appropriateness or adequacy of the recommendations are negotiated with the contractor until mutual agreement is reached and revised recommendations from the contractor are submitted.

The Chief Valuer confirmed this approach in his evidence:

The role as I see it of the contract manager is one to be satisfied, if you like, that the values of the contractors are writing are reasonable. Rather than directing the contractors to write certain values, its about questioning areas of doubt to be satisfied.

The contract valuers and contract managers interviewed as part of the investigation echoed this:

They would query us, but there was never any pressure put on us to change our valuations to their figure. It was our decision. We were independent in making our valuations. [Anthony Boshel, former contract valuer, Property Valuation Service, Kiama district]

If we sought to have something changed for some reason or other, then they don't say "yes" and hang up and change it and send it back to us. If we can justify a reason for that happening, that will be considered. If they don't agree with it, then they won't do it. We have a very good relationship with them on that level. Like we really do sit like that, like they are – we don't dictate to them what to do and, you know, we are more than accepting of their advice on some things, and they are more than accepting of advice from us on different things, but we don't dictate to each other. [Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hasting/ Greater Taree district]

...my role is I'm checking a procedure, or checking what they've done. I'm not out there to check their values.

Q. No, so to that extent you are basing it on trust, of them being professional valuers –

A. Exactly.

Q. – and doing the right thing?

A. Exactly. Again, I'm not out there to check every one of their valuations; I'm checking a process that's in place as to the way they should do something. [Mark Glanville, District Valuer, contract manager Lane Cove district]

In relation to the second issue, the content of the MAR is usually delivered electronically as separate reports that build up into the collective MAR. Up to 2003, there was not necessarily an inviolate record of the MAR as was delivered by the contractor on a certain date. The component valuation report for example might be updated as the result of further sales analysis or in response to feedback/questioning from the contract manager. After sign off of values, additional sales were still able to be added to these reports but the factors could not be changed. Since 1 July 2004, all iterations of this data have been retained.

4.5.2.2 Sales analysis

The core of the valuation program is sales analysis. The *Procedures Manual for Contract Valuers* says “the most important part of the valuation process is the interpretation of the market as at 1 July. No amount of valuation skill will overcome an inadequate analysis of the market”. All sales that assist in establishing market level valuations at 1 July are required to be analysed. There is no prescribed number or percentage of sales required to be analysed. It is a judgement call on both the part of contract valuers and contract managers –the contractor has to be satisfied that they have enough analysed sales to back up their valuations and the manager has to be confident that enough sales have been analysed to support the benchmark valuations and component factors.

The Chief Valuer gave the following evidence that is illustrative of this issue:

THE ASSISTANT OMBUDSMAN: Q. How do you work out whether a contractor has sufficiently analysed the market?

A. Well, I guess it starts from have they analysed a substantial body of sales is the first point ...

Q. Is that an absolute number, or is it a proportion of sales in a district?

A. No to both of those things. It could be 100 per cent of the sales in a district, or it could be a sample of the sales in a district, essentially depending upon the volume of sales, so it's more related to a number I suppose than a proportion. You know, should we in the procedures manual publish, "You will analyse X sales," I don't believe that would be an appropriate way to proceed. I think more appropriately is that – and I know this is one of the concerns that there is a reliance on valuers making professional judgment, but I think that's part of the nature of valuation, that at times valuers do need to make a professional judgment and the valuers, in analysing the market, need to be confident that they have analysed enough of the sales that they understand what is happening in the market. I think that's really the key driver.

For example, if we take a simple example, if we went to one of the developing suburbs where there's substantial numbers of sales of vacant land, and many of the blocks are essentially the same, there may not be a great need to analyse a large number of those sales, simply because analysing a comparatively small proportion of the sales and then applying values – and looking at those compared to the other raft of sales that exist would give a good level of confidence that the values are correct. Naturally, you know, as you come to areas where there are less sales available, particularly less sales of vacant land, or there's greater diversity, naturally you would need to analyse a greater proportion of the market to gain a good feel for how it's operating.

While it is a judgement call, contract managers are usually in a difficult position in terms of assessing whether sufficient sales analysis has taken place and doing something practically about it if there is any concern because of the late notice they get of the sales analysis:

How do I know that enough sales have been analysed by the contractor? I don't really know, and I don't really know how many sales he's analysed until the end of the result when he's finished his market analysis. As I said, most of his sales are analysed towards the very end of the program, and so having a report early in the year, February/March, would probably give us a very negligible response as far as what he's doing in relation to that. So – but having knowledge of how many sales there were I suppose would be good to run a – even if it just came in when the valuations came in and you were told that there were 600 sales that took place in Kiama and the analysis shows that they've done 350, well you might say that's a fair representation of it. Again, you could do 350 in the one suburb if it's all vacant land... which would be useless to anywhere else. So you would just want to make sure that the cross cover or the coverage was sufficiently over the whole of the district.

Q. So you need a breakdown?

A. Yes, probably by suburb or something like that

[Ray Jones, District Valuer, Wollongong and contract manager Kiama district]

Our examination of 11 district files indicated that MARs are not necessarily delivered on time according to the contract schedule. Of the eight district files where it was possible to identify a delivery date for the MAR, at least three were delivered late (between 4-10 days). As the Valuer General is himself under a strict contractual deadline to deliver land values to the Office of State Revenue for land tax purposes, late delivery of reports from contractors seriously impedes the ability of contract managers to thoroughly examine these reports for quality control purposes or to enable any corrective action if deficiencies are identified.

4.5.2.3 Reliance on dated sales

As valuation recommendations have to be made as to the value of each property on a particular day, 1 July, the best evidence to support those valuations is the analysis of sales transacted as close to that base date as possible. As stated in the procedures manual, “there is little value in providing sales that are removed in time from the valuation date in a either a rising or falling market. Sales removed from the valuation date should only be used where there is little market movement or to support the movement in the market for an earlier date”.

One of the common complaints aired by both contractors and contract managers throughout our inquiry was the difficulty in doing this. The main problem appears to be the lag time in banks and solicitors registering transacted sales so that contractors may not be made aware of sales transacted in the month either side of the base date until one or two months later. Their market analysis therefore tends to be biased towards sales conducted in earlier times that have to be adjusted to the base date. This presents problems of its own (see 4.5.2.4 below).

... the closer you get to the base date, the less evidence you have, because the closer you are to it. There's less evidence, less information coming to you. You don't –when you make a valuation in 2004, probably at least a third of the sales haven't –you haven't even seen. [Michael Payne, contractor valuer, Crown Valuation Service, Woollahra/Waverley district]

They're obviously trying to get sales that are closest to the base date, so with the lag in time when contracts are actually exchanged, go in through the system, get registered on Land Titles, come back into the Valnet system, six or eight weeks has passed. So when they're looking at sales for July, they won't be receiving them until September. They're due to have the thing finished, their program finished in October, so they're trying to squash up all the relevant, in inverted commas, sales into a very close, short time frame, which is usually very near to when they want to produce the goods. [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]

While the contract and procedures manual assume that sales analysis will take place throughout the year, an analysis of the monthly progress reports submitted by contractors' shows that many contractors undertake the analysis of sales in the latter part of the year. As illustrated in Table 2, much of the sales analysis gets done close to the date of submission of the Component Valuation Report and Market Analysis Report.

Table 2. Examples of the number of completed sales analyses reported in monthly progress reports

Monthly report (2004)	Cumulative number of completed sales reported at end of month			
	Greater Taree	Hastings	Woollahra	Rockdale
July	25	31	(68)	–
August	25	60	132	109
September	31	99	142	126
October	60	146	169	142
November	–	–	175	

Given that Component Factor Reports used up to 2003 were due no later than the second week in September, the above table also is indicative of the problem of those reports not being informed by a comprehensive market analysis. Valuation contractors based those reports upon draft Component Valuation Reports. At the time of their submission it appears a number of contractors would not have completed the full sales analysis, which they later submitted with the MAR. This may explain why initial component factors may be justifiably updated following the analysis of further sales undertaken during October. Even now, when the Component Valuation Report is submitted with the MAR no later than

the second week in October, following feedback from contract managers, more sales may be analysed and included and component factors updated prior to them being locked and proposed values being submitted.

The lag on registration of sales close to the 1 July base date and that information being made available to contractors for analysis together with the delay in undertaking sales analyses means there tends to be a heavy reliance upon sales transacted in the early months of the year.

While all contractors analyse a range of sales to identify the general market movement, for the purposes of performing the quality statistical checks they are instructed to identify a smaller sample of sales most close to the base date.

The *Procedure Manual for Contract Valuers* requires contractors to preferably run the statistical reports on sales falling within 2 months on either side of the base date where there are sufficient sales (at least 50 are required). If a wider range than this is used, the contractor must identify the range adopted. So the statistical reports are generally run on the 'best' evidence –that is the sales closest to the base date.

We examined a number of these statistical analyses to identify the age of the 'best' sales relied upon which are reported in table 3.

Table 3. Age of most recent residential sales used for calculation of quality statistical measures – 2004 valuation program – sample of 44 districts

District	Contractor	Total Residential Sales	% residential sales within 2 months of base date – May-Sept	% residential sales older than 2 months but less than 6 months from base date	% residential sales older than 6 months but less than 12 months from base date	% residential sales older than 12 months from base date
Leichhardt	QV	23	4	39	22	35
Strathfield	QV	24	0	21	33	54
Sutherland	SAVS	84	69	31	0	0
Greater Lithgow	PVS	15	7	60	33	0
Singleton	PVS	29	17	72	10	0
Muswellbrook	PVS	68	1	38	60	0
Mosman	PVS	47	19	60	15	6
Lane Cove	PVS	44	16	52	27	5
Pittwater	PVS	57	12	25	53	11
Kiama	PVS	169	2	39	56	2
Shellharbour	PVS	114	1	94	5	0
Shoalhaven	PVS	338	36	56	7	0
Bega Valley	PVS	122	20	43	35	2
Wagga Wagga	PVS	35	3	23	69	6
Ashfield	QV	33	39	39	12	9
Burwood	QV	11	27	9	27	36
Canada Bay	QV	21	14	10	14	62
Hunters Hill	QV	41	10	29	56	7
Marrickville	QV	54	11	43	39	7
Camden	QV	205	15	34	52	0
Sydney City	QV	44	25	61	14	0

District	Contractor	Total Residential Sales	% residential sales within 2 months of base date – May-Sept	% residential sales older than 2 months but less than 6 months from base date	% residential sales older than 6 months but less than 12 months from base date	% residential sales older than 12 months from base date
North Sydney	PVS	34	3	65	26	6
Woollahra	CVS	71	34	31	21	14
Waverley	CVS	101	48	29	13	11
Parramatta	CVS	40	60	33	8	0
Greater Taree	PVS	52	29	42	21	8
Hastings	PVS	60	25	45	25	5
Blacktown	CVS	58	38	22	33	7
Baulkham Hills	CVS	65	54	17	11	18
Ku-ring-gai	PVS	83	18	75	7	0
Wentworth	PVS	50	8	36	56	0
Wingecarribee	PVS	138	28	68	4	0
Blue Mtns	PVS	110	9	79	12	0
Byron	PVS	117	15	46	39	0
Hurstville	SAVS	46	48	52	0	0
Kogarah	SAVS	29	34	66	0	0
Rockdale	SAVS	35	49	51	0	0
Bankstown	PVS	103	71	26	3	0
Great Lakes	PVS	76	20	43	37	0
Wyong	R&R	131	100	0	0	0
Griffith	PVS	26	8	65	27	0
Bathurst	PVS	82	11	44	45	0
Auburn	CVS	31	65	13	23	0
Liverpool	QV	191	35	44	21	0
Total	44	3307	29%	44%	24%	3%

In this sample of 44 districts, only 6 relied upon more than half their sales being within two months of the base date. Some of these were developing districts with large new subdivisions such as Baulkham Hills and Wyong while others appear to be areas simply with high turnovers. 12 districts in our sample had fewer than 10% of their sales within 2 months either side of the base date. Overall, only 29% of all sales relied upon were transacted within two months of the 1 July base date.

Forty-four percent of sales relied upon were transacted between 2 and 6 months before the base date and nearly a quarter (24%) were between six months and a year old. 113 sales relied upon were older than 12 months. In at least two districts (Strathfield and Canada Bay) more than half the sales relied upon were more than 12 months old and sales older than 6 months or more constituted more than half the sales relied upon in 11 of the 44 districts.

These results give moderate support to the contention of some contractors and contract managers that the time lag in getting access to sales information of sales close to the base date means they are forced to rely upon sales older than they would prefer to justify the valuations made.

4.5.2.4 Absence of uniform methodology for valuing improvements

Traditionally, the Valuer General and contract valuers have relied upon sales of comparable vacant land to value benchmarks and derive component factors. This continues to be the preferred approach but there have been two major developments that have impacted upon this preferred approach. The first is simply the decrease in the number of sales of vacant land as urbanisation has taken place. Particularly in established metropolitan areas, there are now few, and in some areas, no vacant land sales any more. Where there are insufficient vacant land sales to undertake a proper market analysis, valuers increasingly rely upon sales of improved properties and make allowances for the value of improvements in order to compare the net land value of those sales properties to the properties they are valuing.

The second development is the precedent laid down in a recent High Court case *Maurici v Chief Commissioner of State Revenue*²³. This case dealt with the problem where the relative lack of vacant land sales means there is not a clear distinction between the market for improved property and that for vacant land so that sole reliance on sales of vacant land may be unreliable due to their being inflated by a scarcity factor. The Court found that the sales of scarce vacant land were likely to involve a special and different class of buyer from buyers of improved land and were “unlikely to provide a reliable indication of [unimproved] value”. Further, the Court held that in valuing notionally unimproved land, the sales of improved land cannot be disregarded, particularly in the case of a scarcity of vacant land.

Practice since *Maurici* has been to analyse improved sales to a much greater degree to establish that land values are in line with broad trends in the property market. The case also highlighted the need to assess the added value of any improvements that form part of an improved sale. This is something more than simply deducting the estimated cost of improvements from the selling price.

It was apparent from our interviews with contract valuers and contract managers that while there are generally common approaches, there are different practices followed in valuing improvements. When asked “do contract valuers all use the same methodology to assess the added value of improvements when they analyse sales of improved properties?” some of the typical replies we received were as follows:

- A. *I would suspect not.... the magnitude of the differences that I saw this time with some properties indicates that the answer to your question is definitely no. If they did use the same sort of methodology then my expectation is the differences that I saw this year in some areas wouldn't be the case.* [Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hasting/Greater Taree district]
- A. *No, I don't think they do. I don't think all valuers in the same office use the same methodology.* [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]
- A. *My understanding is that there's no formalised requirement in terms of the analysis of sales. So there's no consistency in terms of approach between valuation contractors or, indeed, possibly within an individual firm who's contracting out work. In saying that, that can generally be the case anyway in regard to how a valuer would undertake a valuation out there in the private sector. There are different methods of undertaking that, but my view would be that, because we are looking at a rating – effectively, a rating and taxation base, that there does need to be some consistency in terms of approach.* [Valuer General]

Some contract valuers also reported that different contract managers favoured different approaches that they expected them to adopt. The fact that there may be variations in approaches adopted by contract valuers means it is yet another factor that may contribute to a margin of error and inconsistency across districts in the valuation of land.

All valuers interviewed favoured the introduction of a guideline to help ensure consistent practice across valuation districts. During the latter part of the investigation in April 2005, LPI drafted such a guideline that addressed the preferred approach to sales analysis methodology for general valuations. It dealt with residual land value analysis by using the paired sales approach, by using the replacement cost approach and also addressed use of the hypothetical development method and the issue of depreciation. The draft guideline also proposed a methodology for adjusting improved sales to the base date. A final version of a guideline was issued to all valuation contractors in July 2005 and has been incorporated into version 5.0 of the *Procedure Manual for Contract Valuers* for use in the 2005 valuation program.

4.5.2.5 Adjusting sales for time

The analysed land value deduced from the analysis of sales information is the land value at the contract date. Unless the market has been completely stable during the time between the contract date and the base date, the analysed land value must then be adjusted for time to take account of the market movement. This is done in order to bring all the sales information to a common base date so that those values can be used for purposes of valuing the benchmarks by the comparison method. This is a critical part of both the traditional and component method of valuation. If a benchmark valuation has been based upon comparison sales information that has not been adjusted properly, the resultant benchmark valuation may itself be defective. As the benchmark valuation is used as the

basis for deriving component factors that are then used to generate the new valuations, a domino effect is possible reducing the reliability of the resultant values of most properties in affected components.

The *Procedure Manual for Contract Valuers* provides the following guidance on adjusting for time:

Where sales are adjusted to the valuation date as the base date of 1 July, evidence of value movements or rationale must be provided. The minimum requirement is evidence of sale and re-sale or sales of like properties at different dates. A rate of change without the sales evidence is insufficient

We found no such evidence supporting adjusting factors in any of the Market Analysis Reports or district files we examined as part of the investigation. Adjustments factors were usually expressed as a calculation in the sales analysis sheets but usually no rationale was supplied to justify these factors.

We also found many anomalies in the adjustment factors used and many instances where analysed land values were not adjusted for time despite obvious movements in the market as indicated by the increases illustrated in adopted component factors.

4.5.2.5.1 Variations in adjustment factors for time

In a number of districts that were the subject of focus in the investigation, we identified sales that had been adjusted by factors that were at variance with the general market movement. This problem is best illustrated by talking some specific examples and canvassing the evidence of the contractors responsible and commentary by others.

- Adjustment case study 1: 127 North Kiama Drive, Kiama Downs.

This property was sold on 18 August 2003, 10 and a half months before the 1 July 2004. It is generally recognised that the market movement in most districts including Kiama during 2003–2004 continued to rise from 1 July up to October–November when the market plateaued. The contractor adjusted the analysed land value by a 2% increase to bring it to the base date. The property however was part of a component where the factor increase was 10% for the full year.

The contractor provided the following explanation for this variation:

It possibly could have gone up a little bit more. I felt the market in Kiama was moving reasonably well at least until January. I thought – to be honest, I thought generally that – I'd better be honest. I'm on oath. Sorry. I thought that – I thought I had increased them 5 per cent in those situations where I had – by October, say, I thought they had been – generally my adjustment would have been about 5 per cent in those situations, yeah. So if I – if I had the chance to do that one again, my adjusted land value would be at least 5 per cent higher than my analysed land value. [Anthony Boshel, former contract valuer, Property Valuation Services, Kiama district]

The contractor stated that adjustment factors must take account of the particular property characteristics which means it may be adjusted for time at a different rate than the general market movement in that component or the district as a whole:

THE ASSISTANT OMBUDSMAN: Q. Just so I can understand your argument, are you saying that when you're analysing a sale and applying an adjustment factor to bring it to the base date, you're making judgments about market movement as it particularly applies to that property, so the fact it's on a main road or something may affect the factor increase or decrease that you would apply to adjust it to the base date?

A. Most definitely.

Q. And that can be quite different from the increase or decrease that you would apply at the component level?

A. Most definitely and you will also find that occurs with special properties with special attributes, as in properties with an ocean outlook...

The contract manager had actually questioned the adjustment on this property because it had a delayed settlement:

The fact that they have adjusted it, I would have thought that's okay, they've made an adjustment, and it would have only have been by flicking through other sales in the location that I might have thought it was out of line, but it's in North Kiama Drive, it's up a fairly high level price range, but they won't all necessarily adjust in the same range, as far as adjustments would be concerned, as far as market is concerned. The higher priced ones probably don't increase as much as maybe the lower priced ones, so I probably wouldn't have queried that in relation to component (inaudible), no.

THE ASSISTANT OMBUDSMAN: Q. Would you expect the adjustment factor to be similar to the component factor?

A. In some cases – in most cases I suppose I would expect it to be, yes, near it – not necessarily exactly but somewhere near it, maybe. [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]

- Adjustment case study 2 : 12 Albert Street, Hallidays Point

This property was sold on 12 August 2003, 11 months before the base date. The adjustment factor shown on the sales analysis report was zero. The property was part of a component where the component factor increase was 8%. The contractor made the following observations upon this example:

We had later sales which were closer to the base date. Yeah, it – oh, I wasn't the valuer that actually did this, but, well, principally, we used the later sales. With this area, there were no vacant land sales at all, so we used the improved sales. We're often advised that we – by our contract managers to be on the conservative side and this sale was actually a – it looks like it was being demolished, the house. And the problem with one-off sales where houses are demolished is that someone, a landowner may say, "Oh, well, that house was worth 40 or 50 or \$100,000. It had a value." So you really need to be careful where there's only one sale where the house has been demolished, and from my recollection – yeah, I think there were only four or five sales at Hallidays Point as it was and my recollection, this was the only one that was demolished. So we tend to place greater weight on ones that are closer to the base date where the improvements remain rather than just one-off sales essentially.

THE ASSISTANT OMBUDSMAN: Q. But in analysing that particular sale, you're working out what the land value is –

A. Yes.

Q – irrespective of what was there or whether it got demolished or not?

A. Yeah, that's true, but what I'm trying to get across is that, you know, if this had been purchased by somebody else, they may well have retained the house. And then the house for example – the house may be worth more than what we've allowed, \$10,000. We've allowed \$10,000 because it was demolished, but for some other purposes, the house may have been worth 40 or \$50,000, if they'd built around it.

Q. Okay, so you're saying that in deducing an analysed land value from a sale, it's always a bit iffy because it depends, in a sense, on the plans of the purchaser?

A. Well, yeah, we need – you really need to ascertain the intentions of the purchaser.

Q. But the fact that you've actually deduced a land value prima facie suggests that you've actually been through that decision-making process –

A. Yes, yes.

Q. – and taken into account whether the house was demolished or not demolished –

A. Yes.

Q. – and said, "Well, the land was worth X at the date of contract"?

A. Yes, it –

Q. Now the point is that, from that point on, you've adjusted it to the date, to the base date, and in this particular case, it's almost the full year, but you haven't made any positive adjustment for an increase; yet you're saying in the component, the values have gone up?

A. Yeah.

Q. Well, how does – I mean, it doesn't make sense.

A. It doesn't. That sale should have been adjusted. Even if it was only by a small amount, it should have been adjusted. [James Tyrpenou, contract valuer, Property Valuation Services, Taree/Hastings district]

- Adjustment case study 3: 38 Epping Road Woollahra

This property sold exactly 12 months before the 1 July 2004 base date. In this case the analysed land value at the date of contract was reduced by 10% to account for movement in the 12 months up to the base date. The contractor commented upon this as follows:

...to adjust a sale to base date we have to compare – look at the way the market has moved between 2003 and 2004. Again, there is very, very little evidence when you are so close to the actual period that it is happening. I can look back now and say that for 2003, you know, between March and September the market was moving at

3 per cent a month. When you are sitting right in the middle of it, it is very hard to pick that, because the information –

THE ASSISTANT OMBUDSMAN: Q. That is because of the time lag in getting sales data?

A. The time lag, information just isn't available. Now, what we do is – again, as I have said before, we will resolve down in favour of the rate payer. Now, there will be certain information that we will have which will show the way in which the movements have occurred, and there will be other anecdotal information, there will be asking prices, properties selling and then reselling or perhaps going up to auction a second time, not selling but having a highest bid. We use all that information to derive a movement between 2003 and 2004.

What we do is we will take an aggressive approach, because we just don't – you know, the information is not definitive. You know, if we think the market has moved back 10 per cent, we might move it back 13 per cent just to, once again, give the benefit of the doubt in favour of the rate payer. What we did, we looked at all the sales, resales, spoke to agents, looked at the highest bids and properties selling and attempting to resell within that period between 2003 and 2004 and we mapped a graph of what we saw as the movement. The reason we mapped a graph was that any sales that we were using in the report we could then pinpoint and say, "Okay, this property sold in September. Therefore, in September the market was here. We will make this adjustment down to 2004."

So whereas – these are probably, in my opinion, again, looking back now from a little further distance, we were probably a little bit too aggressive with the rate of movement. Ten per cent probably is too – in retrospect is probably a little bit too much.

MS BRUNT: Q. Following on from that and looking at MFI21, even though the value went down by 10 per cent during the year, the factor for the component indicates that the values went up by 18 per cent.

A. Yes.

Q. Can you reconcile that difference for us?

A. Well, once again, I would have to just reiterate that it's possibly a combination of the values probably being a little bit low based on the misinterpretation of the rate of movement in 2003 and complying with stats in 2004. Also, the time line that we give in terms of the adjustment is a generic one that we use throughout the eastern suburbs, because we're picking up information all through the eastern suburbs. It's a means of getting all the analysed sales to a common base date of 2004. Now, that doesn't mean that the whole of the eastern suburbs has gone up and gone down by that amount between 2003 and 2004. There will be – it is a means of getting the analysed sales to a consistent basis as at 2004. You may find that Double Bay in fact has moved in a different direction to that.

I think what he's doing is he's confusing the rate that we're using to adjust sales to get some commonality to the analysis and what is possibly happening in the marketplace.

[Michael Payne, contract valuer, Crown Valuation Service, Woollahra/Waverley district]

As these three examples illustrate, there appears to be a high degree of imprecision in the adjustments for time made in individual sales analyses undertaken by contract valuers. It is also difficult for contract managers to identify deficiencies with adjustments due to the lack of information provided to them about the rationale and data relied upon at the time that component factors are approved:

Q. Is there any way, sitting in the contract manager's seat that you can work out whether the adjustments made are relatively accurate or not?

A. Only by – only by reviewing the evidence that they put before me...

Q. And in the normal reports that come through as part of the contract do you normally have access to that evidence?

A. On an ongoing basis, no. You only get the report at the end. Initially you get – you might get – you'll get some at the beginning of the program where they might provide you with some evidence to show why they're making the movements. Up until that time, the sales they're using go over this overlapping period, so you won't get it all and you won't be able to examine it all at the point you actually approve the values.

[William Webster, District Valuer and contract manager, City of Sydney]

4.5.2.6 General failures to make adjustments for time

While the above case studies are indicative of the problems involved in adjusting individual sales for time in preparing the general market analysis, in our review of a sample of the raw sales data used to calculate the quality statistical measures we found a number of examples where none of the sales at all had been adjusted for time. When we drew some of these to the attention of the Chief Valuer he conceded it presented a problem:

MS BRUNT: Q. In looking in depth at several districts, we have identified quite a number of analysed sales that have not been adjusted for time. However, there is evidence that the failure to make adjustments may be happening on a much wider scale. Can I show you marked for identification document number 63, which is a selection of sales lists used in the statistical analysis reports. It includes Mosman, Lane Cove, Hurstville, Rockdale, Canada Bay, and Strathfield. We have highlighted in yellow the analysed land value at contract date and the adjusted land value at the base date of 1 July 2004. As you will see, despite many having sales in the very early part of 2003 or older, there are no adjustments for time at all. Can you comment on that?

A. Well, that concerns me I guess is the first point I would make, particularly in terms of – I have some difficulty in thinking in the context of the statistical analysis report how it would be likely to work if they have not made those adjustments. As to whether there's any sound reason for it, I can't tell, but prima facie I'd suggest that it indicates there's a problem with these ones.

Q. These sales were used to value the benchmarks and the component factors derived from that process. If the sales were not adjusted for time, doesn't that suggest that the basic data used to value the benchmark properties in those districts was faulty and so the valuations derived from that process may not be as accurate as they should be?

A. It's certainly a risk, I'd have to say. Once again, as I think I said earlier on, the adjustment of sales and how they are applied, in the end – whether that produces correct valuations or not in the end depends on the understanding of the valuer, you know, valuing the benchmark. If the valuer valuing the benchmarks has taken into account that they haven't made adjustment for the market, then maybe they've taken that into account in making the valuation, but I can't judge that from this clearly, but at face value this would suggest that there's a problem.

From a sample of thirty nine districts where we could discern the adjustments for time from the raw sales data used to produce their quality statistical measures, we found over 40% had not adjusted any of the sales for time and a further 20% had adjusted less than 10% of the sales for time. These results are set out in the table below:

Table 4. Adjustment of analysed land values for time – sample of 39 districts (2004 valuation program)

District	Contractor	Total Residential Sales	No of sales where analysed land value adjusted to base date	% of sales adjusted to base date
Leichhardt	QV	23	18	78
Strathfield	QV	24	0	0
Sutherland	SAVS	84	2	2
Greater Lithgow	PVS	15	0	0
Singleton	PVS	29	0	0
Muswellbrook	PVS	68	0	0
Mosman	PVS	47	0	0
Lane Cove	PVS	44	0	0
Pittwater	PVS	57	0	0
Kiama	PVS	169	87	51
Shellharbour	PVS	114	0	0
Shoalhaven	PVS	338	123	36

District	Contractor	Total Residential Sales	No of sales where analysed land value adjusted to base date	% of sales adjusted to base date
Bega Valley	PVS	122	11	9
Wagga Wagga	PVS	35	30	86
Ashfield	QV	33	25	76
Burwood	QV	11	2	18
Canada Bay	QV	21	2	10
Hunters Hill	QV	41	17	41
Marrickville	QV	54	48	89
Camden	QV	205	169	82
Sydney City	QV	44	33	75
North Sydney	PVS	34	0	0
Woollahra	CVS	71	60	85
Waverley	CVS	101	31	31
Greater Taree	PVS	52	5	10
Hastings	PVS	60	7	12
Ku-ring-gai	PVS	83	0	0
Wentworth	PVS	50	11	22
Wingecarribee	PVS	138	0	0
Blue Mtns	PVS	110	0	0
Byron	PVS	117	0	0
Hurstville	SAVS	46	1	2
Kogarah	SAVS	29	0	0
Rockdale	SAVS	35	0	0
Bankstown	PVS	103	1	1
Great Lakes	PVS	76	2	3

The failure to properly adjust analysed sales for time is a concern recognized by some district valuers responsible for managing valuation contracts as the following evidence attests:

So I really can't answer that question other than to say that it's a problem in this region, and I suspect it's a problem state-wide ... There are a lot of examples where the sale price is listed, the adjustment to base date is no different to the sale price, and the factor proposed – and that property is within the component – and the factor proposed in here is 1.2 or 1.3, which is hypocritical and defies logic.

So that's an area that, this year, I have identified and we have spoken to our contractors about, in an after-sense, rather than a before-sense, because that's only been apparent to me this year.

THE ASSISTANT OMBUDSMAN: *Q. All right. In fact you are not talking about the difference between the sale price and the adjustment to base date; you are talking about the land value price and the adjustment to base date being the same?*

A. Yes. Yes. So there's been no adjustment made for time on an old sale, yet the factor indicates that from the contract date of that old sale to now there's been an increase. So that conflicts dramatically with that, and I think Hastings and Taree, there will be examples of that occurring....

THE ASSISTANT OMBUDSMAN: Q. ... it seems to me that if you don't adjust the sale to the base date, then how can you use that information at all?

A. Exactly. And you can adjust it to the base date with zero, providing the market hasn't moved. There's no drama, I don't have a problem with that, but while ever we have issues with –

Q. But you work out whether the market has moved from the sales information?

A. Yes.

Q. So unless you are adjusting them correctly you don't know how the market's moved?

A. Exactly. Yes. No, I agree wholeheartedly ... – it's a problem area big time.

[Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hasting/Greater Taree district]

4.5.2.7 Absence of use of a uniform methodology to adjust for time

There are a number of methods available to valuers to time adjust sales for mass appraisal purposes including average unit value analysis, sales ratio trend analysis, multiple regression models and paired sales analysis²⁴. The *Procedure Manual for Contract Valuers* requires evidence of the adjustment rationale to be provided by contractors and specifies that the minimum evidence is paired sales analysis. While we found no examples of such evidence being provided in any of the documents we examined as part of the investigation, it appears that paired sales analysis is the method most likely to be used. There is, however, wide variation in the technical precision with which contract valuers approach the task.

We saw evidence of some contractors graphing market movements to assist them work out adjustments factors. Other contractors appeared not to have any documentation to support the adjustment factors they applied to particular sales:

... So, by aggregating all that evidence, you can work out a timeline for 12 months.

Q. And do you do that for the whole district or components?

A. Essentially for towns, yeah, or for a group of components. It depends on the amount of evidence you have, obviously, but essentially it's a group of components. So it might be for Taree town, for example, or for Old Bar, for Wingham, because, you know, Old Bar being on the coast has different factors to Wingham. Wingham values increased much later than Old Bar values did.

Q. Okay. So would you be able to show us the source document you used for, say, Old Bar in the last valuation?

A. No, I haven't. I didn't actually prepare one for that case. Like, see, the problem with the last round of valuations was that there wasn't a great deal of sales evidence to show that. Like, we had the sales closer to the date and earlier sales, so essentially it wasn't on a rate per month as such. It was a case of comparing the earlier sale with the sales closer to the base date and saying, okay, well, if this sale which took place in January is valued on the basis of this sale which took place in June, you would arrive at a higher value. You know, more in comparison with what the sales took place – what the sale was that took place in June. So for the last program, I didn't actually prepare a timeline, but it can be done if there are such sales. [James Tyrpenou, contract valuer, Property Valuation Services, Taree/Hastings districts]

Clearly, determining appropriate adjustment factors is at times a difficult task especially when the market is volatile or when there are few sales and re-sales of properties or sales of comparable properties at different points of time as the evidence of the following contractor attests:

When we analyse properties, we have to bring them to a position where it is assumed what would be the price that it would sell for as at the base date – let's go back to 1/7/03. So we made adjustments to sales. In 2003 the market was actually moving upwards. In 2004 the market was coming back. We value very close to the time – there is very little time between the time that we have to make the valuations and the time that the information that we have is available, especially with adjustments to time. What we tend to do is take a conservative line, and that's what we did in 2003.

With the evidence that we had, we were showing the market moving up at – I think it was 1 per cent per month, adjusting sales to that basis, on that basis. Looking back, the market was racing, and we didn't pick up that

movement. The market was probably moving in certain areas 3 to 4 per cent a month between March and up to September/October. It started slowing down in September and it peaked in October.

With our analysis and adjustments to analysis of sales in 2003, we were using 1 per cent per month. When you look back at what actually happened, the market was actually moving much faster than that. Consequently, the value levels are based on the sales which produced a slightly lower value than probably would have been the case had you known and applied those 3 per cent movements in the adjustments to time.

THE ASSISTANT OMBUDSMAN: Q. So if the adjustments for sales were not as accurate as they should have been, did that lead to a general undervaluing in the area –

A. In retrospect –

Q. – in 2003?

A. In retrospect, probably, yes. [Michael Payne, contract valuer, Crown Valuation Services, Woollahra/Waverley districts]

All of the contractors and contract managers interviewed for the purposes of the investigation agreed that it would be desirable to encourage use of a uniform methodology to adjust sales for time. During the course of taking evidence, the Chief Valuer actually initiated action to issue a guideline to contractors on the methodology to be used for time adjustments. It has been incorporated into version 5.0 of the *Procedures Manual for Contract Valuers*. Valuation contractors are required to implement the guideline for the analysing of sales for the 1 July 2005 general valuation. We endorse this move. In addition, the procedures manual should be amended to require contractors to provide details of the actual calculations and data sources used to develop the set of adjustment factors applied in their sales analysis as part of the Market Analysis Report. It is expected that these requirements will be further refined during the coming year.

4.5.2.8 Verification of benchmark valuations and component factors

Following the market analysis, every benchmark property in each component is valued by the traditional valuation method. For most properties this is the direct comparison method. This is a crucial part of the whole mass appraisal process and the *Procedure Manual for Contract Valuers* emphasises that it must be done with a high degree of skill. As each valuation has to be capable of being supported by the market evidence, and most valuations are made by applying component factors derived from benchmark valuations, it is crucial that the benchmark valuation itself is capable of being supported by the available market evidence.

Valuation contracts require contractors to supply a Component Valuation Report no later than the second week of October. These reports provide a list of the key sales that were relied upon to value the benchmark properties in each component as well as the benchmark valuation and the proposed component factor. These reports can be quite voluminous depending on the number of components in a district and the number of benchmarks within each component. Of the sample districts examined during the investigation, the number of components ranged from single figures to over 300 and the number of benchmarks ranged from 1 to 19, although the majority had only one.

The *Procedure Manual for Contract Valuers* requires that the Component Valuation Report for each component must include:

- A summary of the sales that are to be used in the valuation of the benchmark with “extensive comment describing the relativity of the sale to the benchmark”
- The valuation of the benchmarks including “details of the methodology and calculations”
- Benchmark comments containing brief topographical and location features and where direct comparison cannot be used, “details of the methodology and calculations must be attached on a worksheet”
- Comments upon the accuracy of the result after the component factor is applied and the degree of handcrafting required
- A graph indicating the benchmark, sales and land value relationships “where appropriate”
- And a table summarising the statistical checks for each component to be provided with the completed values file

While the general format for these reports is prescribed, there is variation between valuation contractors, and even within the same contracting firm in their strict compliance with these specifications. For example, apart from inclusion of phrases such as “BM has been valued by direct comparison with available sales evidence”, in none of the Component Valuation Reports reviewed did we see any detailed calculations or attached worksheets supporting benchmark valuations or comments upon the accuracy of the result after the component factor applied. More

importantly, few Component Valuation Reports contain “extensive comment describing the relativity of the sale to the benchmark”. The typical comment is something like “recent improved sale, inferior property to BM”. Some reports contain no comments at all relating to the sale to the benchmark. For example, the Component Valuation Report for Penrith district simply stated in the sale comment section the factor increase for each sale property or the \$m2 rate.

The *Rating & Taxing Valuation Contract Management Procedures Manual* requires contract managers to sight check every individual component report to determine if there is adequate sales evidence and that the sales evidence is relevant to the benchmark valuation in terms of quantum and location. They are further required to audit a minimum of 5% of all component reports²⁵ in accordance with a component checklist. If the results are inadequate, further sampling is required. The component audit requires among other things that all details be verified, that each sale be individually checked including checking that the comments against it “extensively describe the relativity of the sale to the benchmark”, that photos and plans are attached to each sale, that there is a map showing the location of components and component benchmarks is maintained, and that generally, the “component factor must be supported by the benchmark and sales evidence”. The purpose of such checks is to identify if the process of valuation of the benchmark from sales analysis to component factor has been adequately followed. As well it provides an audit trail to demonstrate the level of regulation applied.

We audited a sample of 24 component checks including those done for five of our key focus districts plus a random selection of 19 other districts. The results appear in the table below:

Table 5. Compliance by contract managers with requirement to audit a minimum of 5% of component reports

District	Total number of components	Number of components checked ²⁶	% checked
Waverley	43	4*	9%
Woollahra	28	18*	64%
Sutherland	123	66*	54%
Parramatta	46	9*	20%
Blacktown	43	11*	26%
Penrith	130	52*	40%
Blue Mountains	78	28*	36%
Greater Lithgow	64	25	39%
Parkes	56	3	5%
Manly	51	37*	73%
Mosman	34	16*	47%
Willoughby	75	22*	29%
Ryde	43	24*	59%
Hornsby	55	25*	45%
Baulkham Hills	33	9*	27%
Shellharbour	70	14	20%
Kiama	91	19	21%
Eurobodalla	94	26*	28%
Bega	151	73*	48%
Wagga Wagga	118	118*	100%
Greater Taree	135	43	32%
Hastings	140	9	6%
Tweed	158	10	6%
Maitland	95	31	33%

On average, we found at least 36% of components reports are checked –significantly higher than the 5% required under the procedures manual.

Following the check, contract managers are required to advise the contractor in writing of components that require further information and clarification. In the majority of cases, contract managers conduct the checks and prepare written comments directly without use of the Component Check form. The Component Check form was used in only 33% of the district audits.

Few files contained a map of the components and benchmarks. Furthermore, while one of the audit requirements is to check that photos and plans are attached to each sale, the evidence of a number of contract managers was that the detailed sales analysis reports were not provided to them at the time of the Component Valuation Report but were provided later with the Market Analysis report. This was probably more the case in previous years than it was in 2004.

It appears that time limitations prompt the majority of contract managers to record their conduct of the component audit directly by way of narrative comments sent to the contract valuer in order to avoid a double recording of information. Another reason may be that the prescribed component check form does not facilitate the audit as best it could. The form as presently prescribed provides for the checking of certain details that are simply not available to contract managers at the time they conduct these audits.

For example, the form provides for checking the benchmark worksheet, the production of which is not required by any of the procedures. It further requires checking certain statistical information, in particular whether the benchmark valuation is within + or – 5% of the median value of the component, and provides spaces for recording the Q range and QRP statistic. The benchmarks cannot be checked for statistical compliance with these measures without presentation of the Component Data Report. That report, however, is presented at a much later time in the valuation program.

Of the component check forms we audited as part of the investigation, a number listed the sales related to the benchmark(s) for each component. Some contract managers ticked the relevant cells relating to those sales properties but also ticked the cells under the benchmark columns for each of these. This makes no sense, as those cells do not relate to the individual sales, only the benchmark property. Others contract managers didn't list each sale – in those cases a tick against the benchmark presumably indicated all the related sales had been checked. Such anomalies raise some doubts about the thoroughness of the recording of the component checks. Certainly, the component check form needs re-designing if its use as an audit tool is to be encouraged.

In the district files we audited there was, however, ample evidence to demonstrate that contract managers were forthcoming and proactive in advising their contractor's of perceived deficiencies in the initial component factor reports. Comments generally canvassed issues such as:

- The need for further sales evidence (often supplying details of further relevant sales requested to be analysed).
- The appropriateness of using some sales due to their age, location, allowances made for improvements or more recent developments that affect their value.
- The failure to adjust sales values for time.
- Issues of consistency in relating sales values to the benchmark valuation.
- Adequacy of comments.
- Need for handcrafting; and in some cases.
- The appropriateness of the benchmark, or the need for re-grading or re-allocation of properties to other components or use of sub-component factors where values movements did not appear to align properly.

Because the contract manager is usually the person involved in reviewing objections from the previous years valuations, and many have long associations with the districts they supervise, most contract managers have detailed knowledge and familiarity with the component structures and often the benchmark and sales properties that are mentioned in the Component Valuation Reports. Indeed, it is suggested that without such detailed knowledge it is not really possible to perform a competent desk audit of the Component Valuation Reports. We asked a number of witnesses whether it was possible for any valuer with some experience with mass valuation techniques to look at Component Valuation Reports and work out whether the valuation of the benchmark is correct and the component factor is correct, or whether you needed some personal knowledge of the actual benchmark properties and the properties used as reference sales? They invariably said direct experience of the area was necessary:

Q. But, as a valuer, can you look at a component report like that, look at the comments about each of the sales properties, the comment about the benchmark, and come to a conclusion about whether that's a fair component factor or not?

A. No, I could not. I could not

Q. So you need other information, do you?

A. I do. If I was a valuer in that district, I would like a feel for the sales, I would like to see what they look like, I would like to see, you know, how they sit, how the land – even though I have some sort of a description there. The eyes of a valuer are probably the most important thing that he can have. [Mark Glanville, District Valuer, contract manager Lane Cove]

A. Put it this way, I wouldn't be prepared to read this and tell you whether the valuation's right or wrong. I don't pretend to be that good a valuer, and I think it's important to bear in mind the context of these reports are produced in – as I said, they're technical communications between two people who are both well aware that they are familiar with the market, so I guess in that context it would be difficult for someone who wasn't familiar with the market in Kiama to look at this and be able to tell whether the valuation was right or wrong. I think that's a reasonable thing to say. [Chief Valuer]

Where further investigation by contract valuers results in revised assessments of either the benchmark valuation or component factor, they generally provide the contract managers with a revised component sheet that is incorporated into the Component Valuation Report.

Following the completion of these component checks and the resolution of any issues arising, the proposed component factors are approved in writing. The contract valuers then apply those values and begin their verification and handcrafting process before providing their file of values for uploading into the Valnet system. At that time they also supply a quality statement together with the component data table and other statistical measures that contract managers use to assess the quality outcomes of the process before undertaking data integrity checks and ultimately applying the values.

4.5.3 Contractor quality statement

The *Procedure Manual for Contract Valuers* requires contract valuers to provide a quality statement detailing the quality control checks carried out in each district prior to the final values being added to Valnet. This Quality Control Statement is required to be checked by the contract managers to ensure it conforms to the requirements in the procedures manual.

This statement has to attest to the quality control checks carried out in each district including but not limited to:

- ensuring all properties have been valued;
- ensuring all valuations are within the set parameters;
- that a zone/component code integrity check has been made;
- an in depth value check on those properties that have considerably higher values in relation to the average for land use for example, regional shopping centres, steelworks, large scale unit development, large rural properties etc. A list of the properties identified is to be provided;
- ensure that current and proposed DCP and planning changes that affect valuations have been taken into account;
- that all statutory concession valuations and allowances have been supplied; and
- that statistical check information and component data tables have been provided.

The Chief Valuer in his evidence pointed to this document as being “a pretty important accountability document in the process”.

The quality statements that we examined as part of our district file audit simply attested to the above points without providing any further information.

4.6 Monitoring of outcomes

The integrity of the final valuations arrived at by the component method of mass valuation is based upon a number of building blocks which themselves must have integrity. The two most critical are the allocation of properties into

homogeneous components and the choice of representative benchmark properties. While these processes are primarily based upon the professional judgement of the expert valuer, the quality of the resultant outcomes can be partly assessed through quantitative measures.

4.6.1 Component composition

4.6.1.1 Size of components

The *Procedure Manual for Contract Valuers* suggests that components should not comprise fewer than 20 properties. Components of this size are sometimes unavoidable most commonly in commercial, industrial and special use zones due to the limited number of properties. Handcrafting in those zones tends to be more common so it is not such an issue. Version 3.1 of the manual that applied to the 2004 valuation program stated, however, that residential components with fewer than 20 properties should be examined with a view to:

- Amalgamating the component with another (like) component, or
- Splitting up the component and placing some of the properties into other components with which they are compatible; and/or
- Placing the properties in a component requiring individual handcrafting²⁷

The general rationale for this appears to be a simple one of efficiency – it is more efficient to value properties in larger groups than smaller groups provided those groups are reasonable. Small components by definition tend to comprise highly differentiated properties that often need to be handcrafted in any case.

In our review of statistics for 90 valuation districts in the 2004 valuation program, we found overall that 11% of the components that were predominantly used for residential purposes (this included residential, non-urban and scenic protection components) had fewer than 20 properties.

No one appears to believe this presents any real problem. As the Chief Valuer put it:

In the end, as I said, the overriding requirement of the contract is that the contractors produce reasonable valuations, and so if that requires that there be small groups of properties which need to be considered each time, that's the nature of the market in that area I guess.

It is not in the financial interests of contractors to persist with unnecessary small components as each requires the valuation of one or more benchmark properties, compilation of a separate component valuation report and so on. If they continue to be used, it is reasonable to conclude that the contractor believes that the properties are relatively unique and need to be grouped together.

The caution about components with small numbers of properties arose from the review of the results for 10 districts of the 2001 valuation program undertaken for the former Valuer General by Associate Professor John MacFarlane of the University of Western Sydney. MacFarlane noted that there appeared to be a component size below which there was little benefit in creating a component, particularly those where there was a high variation in the values indicating that they may not be comprised of comparable properties.

Professor MacFarlane gave evidence to the inquiry held as part of this investigation and confirmed that the concern did not apply to small components where the values were verified or otherwise handcrafted. This is in fact what predominantly happens in these small components:

Q. In the 2002 report that you prepared, you expressed concern about components with fewer than 20 properties. Are components with fewer than 20 properties only of concern if component factors are applied for those properties?

A. Yes, I would think that's the case. Certainly, components can have any numbers of properties if there's a fair bit of handcrafting going on, virtually individual valuations. Then I don't think it really matters very much what the size of the component is. But if a more mass appraisal approach is to be used and component factors are going to be applied, then I do have some reservations about how small the component might be. On the other hand, it's important that the component has certain characteristics, and some of those characteristics it's probably easier to see in a smaller component that they might have than in a larger component, particularly the notion – not that all the properties have to be directly comparable. I'm not sure – I'm not a qualified valuer. I'm not sure what your backgrounds are in the valuation area. But I don't think that the component has to be all directly comparable properties, but largely that all the properties are at least going to move together in the same fashion, the price movements are going to be fairly similar.

In a small component, that may be possible with only 20 properties, but it's probably quite difficult to measure. So if the components are to be used, then, yes, I would have reservations about 20 properties. But if certainly individual handcrafting is going to go on, then I would have no concern about 20 properties.

In these circumstances, the excision of the requirement to investigate components with fewer than 20 properties in the 2005 version of the *Procedure Manual for Contract Valuers* (see bullet points above) appears to be appropriate.

4.6.1.2 Homogeneity of components

The identification of components is a subjective process of classifying like properties that experience similar movements in value. For the component method of mass valuation to maintain its integrity over time, the components must be well chosen initially and then be continually reviewed. The review is for the purpose of ensuring that the attributes of the properties that were used to group them together remain the important determinants of their land value movements. While properties do not have to be necessarily identical or even be adjacent to be part of a particular component, they usually display particular distributions of land values. Ideally, their land values should fall within a relatively small range and there should be few properties within the component whose values are significantly different from the bulk of properties. Such properties called "outliers" by definition tend not to be comparable with others in the component and can have value movements that do not move uniformly with the majority.

The *Procedure Manual for Contract Valuers* requires contractors to keep their components under scrutiny and to utilise a statistical check to flag those components that may be fracturing due to too wide a spread in values. This requirement has applied to all contracts for both the 2003 and 2004 valuation program. The manual requires that contractors investigate any component where there are wide variations in value range identified by the QRANGE and QRP statistics. The QRANGE or inter-quartile range captures the value spread within the middle 50% of values within a component. This range can be expressed as a percentage of the median to get a relative measure by calculating the QRP, which is the QRANGE divided by the median multiplied by 100. A QRP above 50% indicates a high range of variation within a component and the possible need for further identification of properties that may be in the wrong component or that should be individually valued.

The procedures manual says "the acceptable measure for the QRP is less than 50%. Components with a QRP statistic above 50% should be scrutinised to ensure that they consist of comparable properties".

If component review and fine-tuning are being vigorously pursued, over time you would expect that the values of the QRANGE and QRP would be relatively small. Our review of Component Data Tables for a sample of ninety valuation districts revealed, however, that there continues to be a high number of components with high ranges of variation in values as indicated by their QRP statistic as shown in Table 6.

Table 6. Components with QRPs above acceptable standard (2004 valuation program)

Zone	Total No. Districts with zone ²⁸	Total Components in Zone in District	No. of components where QRP exceeds 50%	% of components not in acceptable range
All	90	5657	2708	48
A Residential	72	1885	449	24
B Business	62	609	525	86
I Industrial	66	445	235	53
P Scenic Protection	34	188	100	53
R Non-urban	64	1290	712	55
Z Undetermined zone or zone being changed	57	396	175	44

As can be seen from the above table, in a sample of 90 valuation districts, nearly half the components were found to have QRPs above 50% indicating the need for scrutiny to ensure they consist of truly comparable properties.

In commercial, industrial and special use zones there tends to be greater variations found in value levels and there is also less scope for allocating outlier properties to other components. A greater amount of handcrafting is usually done in these zones (some are entirely handcrafted) so concern about the need for scrutiny of components with QRPs above 50% tends to focus more on residential zones²⁹. The homogeneity of values within residential zones still appears to be low in nearly a quarter of the residential zones across the state although the spread is uneven between districts. For example, among the districts of focus for this investigation, 8% of the residential components in Kiama had QRPs above 50%, 6% in Greater Taree were above, in Hastings it was 18%, and in Waverley and Woollahra, the percentage of residential components with wide variations in value ranges as identified by the QRP statistic was 53% and 60% respectively.

There can be a number of legitimate reasons for why a component may not meet the QRP standard. For example, some residential components in Woollahra consist predominantly of single residential properties but also include some density sites that have higher values and therefore distort the median value and the QRP. Under current component review, those properties are being removed from those components and re-allocated.

Some components may have a wide range of values, however, the properties move in value in a uniform way. In those cases the component is homogenous for purposes of mass valuation. A non-conforming QRP therefore is not necessarily an indicator of defects in the component method of mass valuation, rather it is a quality assurance flag to be used to prompt investigation to determine whether the variations in values are so wide as to mean that the values of properties in different price levels within the component are moving at different rates. If that is the case, then there is a much greater risk that the application of a single component factor will lead to inaccurate values.

Professor MacFarlane confirmed this in his evidence to the inquiry:

THE ASSISTANT OMBUDSMAN: Q. So would it be fair to say that where there's a high QRP, above 50, where there's a wider range of values in a component, the risk of inaccurate values is higher?

A. Certainly, I think it's fair to say the risk is higher. It may not be in every case, but certainly, yes, I would assess the risk as being higher, because this is – I mean, the QRP is only looking at the middle 50. It says nothing about the other values. You always have to be a little bit concerned. I think in every component, the extreme properties should – there probably needs to be closer scrutiny on them just to make sure that they really do belong in this component and it's reasonable that those properties are moving together with the others.

The QRP statistical measure therefore is a prompt for, and an aid to, component review. While there was clear evidence on a number of district files that contract managers identified these non-conforming QRPs following the 2004 valuation program and asked their contract valuers to investigate them further, we were not confident that this is always done or that contractors, either on their own initiative or at the request of contract managers, did any substantial investigation work in response.

QWere you ever aware of the QRP statistics; and, if so, did you take any steps to review the components after seeing the QRP? If not, why not?

A. No, I didn't take any steps. It essentially comes back again to the composition of the components. There are several I notice that are in the commercial areas – like CA, for example, is the commercial area of Taree – where you have properties varying from probably \$100,000 up to \$2m. The 2.16, I believe, from memory, is where Coles is and it's, you know, a property with a large street frontage and a large area. So that's my explanation for that one. But essentially, no, there were no efforts – no changes made as a result of these statistics. As I say, essentially, you need to look at the composition. Component MA, for example, is open space. It's all the open space land in Greater Taree and it varies, what, from \$70,000 to 1.4 million. Included amongst those entries there's a couple of entries that are beachfront caravan park sites, one at Old Bar, for example, and one at Red Head, I believe. So they're the ones that are obviously at the higher end of the range, but the majority, I would imagine, would be well below that.

Q. Did the contract manager query you about this or any other departures from the standards set down for these quality control measures?

- A. *Not as such. The contract manager did – in the approval for each district, did say that they – you know, the statistical analysis did show wide variations and that they needed to be reviewed before the next program.*
[James Tyrpenou, contract valuer, Property Valuation Services, Taree/Hastings districts]

We also had evidence from one contract valuer that he didn't ever see the Component Data Table that contains the statistical information on conformance of components and benchmark properties to the standards set out in the *Procedure Manual for Contract Valuers*. After being presented with a copy of the Component Data Table for the City of Sydney 2004 valuation program and asked to comment on the ranges identified in that report, the valuer who had been the principal contractor for Quotable Value Australia for the City of Sydney gave the following evidence:

...without actually further investigation, I can't go into it much further because this is the first time I've seen these type of ranges. As to how they're produced, the medium land values, do they take into account heritage valuations, do they take into account allowances, do they take into account section 6A1, 6A2 or section 26s. There could be a lot of variances within certain components which may affect your actual to medium but to understand your calculations actually how we got to this far right hand column I would need to actually look at each one on a one-by-one basis.

THE A/OMBUDSMAN: Q. *Isn't this the component data table you actually supply as part of your contract to the Valuer-General?*

- A. *This would be – this was generated from our contract or our computer based systems are based in – when I was with QV, the QV Australia systems are based in New Zealand and they download that electronically straight towards the Valuer-General's. I – throughout the 2004 contract I haven't – I've never seen this document. This would have been a copy generated through a statistical check and I'd say generated with the 2004 report.*

Q. *How long did you work for QV?*

- A. *I was with QV between 2000, I think roughly May 2000, to January 2005.*

Q. *So you've done a number of mass valuation programs?*

- A. *Yes.*

Q. *And you've never seen one of these tables before?*

- A. *I've never seen this table. I thought it might have been actually generated from yourselves.*

[Derek Hill, former contract valuer, Quotable Value Australia Pty Ltd, City of Sydney district]

It would be reasonable to assume on this evidence that there is a significant reliance upon subjective assessment of homogeneity by some contract valuers in reviewing components and that such reviews may not be always based on all relevant available information.

There also does not appear to be any records kept by contract managers of any progressive review of components over different valuation years. This suggests that there is little scrutiny if any of the effect on valuation outcomes from year to year, following component and benchmark reviews.

Our limited review of changes made in the districts of focus in the investigation suggests that fine-tuning of components and change of benchmarks does not necessarily always bring about improved valuation outcomes. To take a few examples:

- Greater Taree: A rationalisation of components was undertaken following the 2003 valuation program reducing the number of components from 183 to 135. There was a 51% reduction in the number of residential components from 72 to 35. The number of benchmarks not in the inter-quartile range was reduced from 30 to 22 however, the percentage of benchmarks not in the interquartile range increased slightly. There were the same number of benchmarks having an actual land value more than +/- 5% from the median value, however, as a percentage of all benchmarks, it now increased from 61% to 83%. Despite the reduction in the number of components, the number of components with a QRP above 50 did not change substantially (52 to 51). In terms of valuation outcomes, there appeared to be an increase in percentage error – the number of residential sales where the variation between adjusted analysed land values and assigned values was more than 15% grew from 36% to 60%.

- Hastings: There was also a rationalisation of components in this district reducing the overall number from 162 to 140. The number of residential components was reduced 27%. Components with a QRP above 50 reduced marginally from 59 to 57. There was a reduction of the number of benchmark properties not within the interquartile range, although the overall percentage was only marginally less than in 2003 (19% as opposed to 20%). The percentage of benchmark properties that did not fall within the standard of having land values within +/- 5% of the median value, however, jumped from 59% to 74%. In terms of valuation outcomes, while the percentage of sales with variations between adjusted analysed land values and assigned values above 15% stayed steady, the overall percentage of residential sales with variations between 5-15% increased from 25% to 38% and there was a drop in the number where the variation was below 5%.
- Kiama: In this district, the review of components increased their number from 89 to 91 although the number of benchmarks reduced by one. The number of residential components stayed the same. The number of benchmarks not within the interquartile range was reduced slightly from 44 to 40 however there was no change in the number that did not meet the standard of having land values within +/-5% of the median value. In terms of valuation outcomes, while the percentage of sales with variations between adjusted analysed land values and assigned values above 15% increased by only 1%, the overall percentage of residential sales with variations between 5-15% increased from 36% to 41% and there was 6% reduction in the number where the variation was below 5%.

4.6.2 Benchmark selection

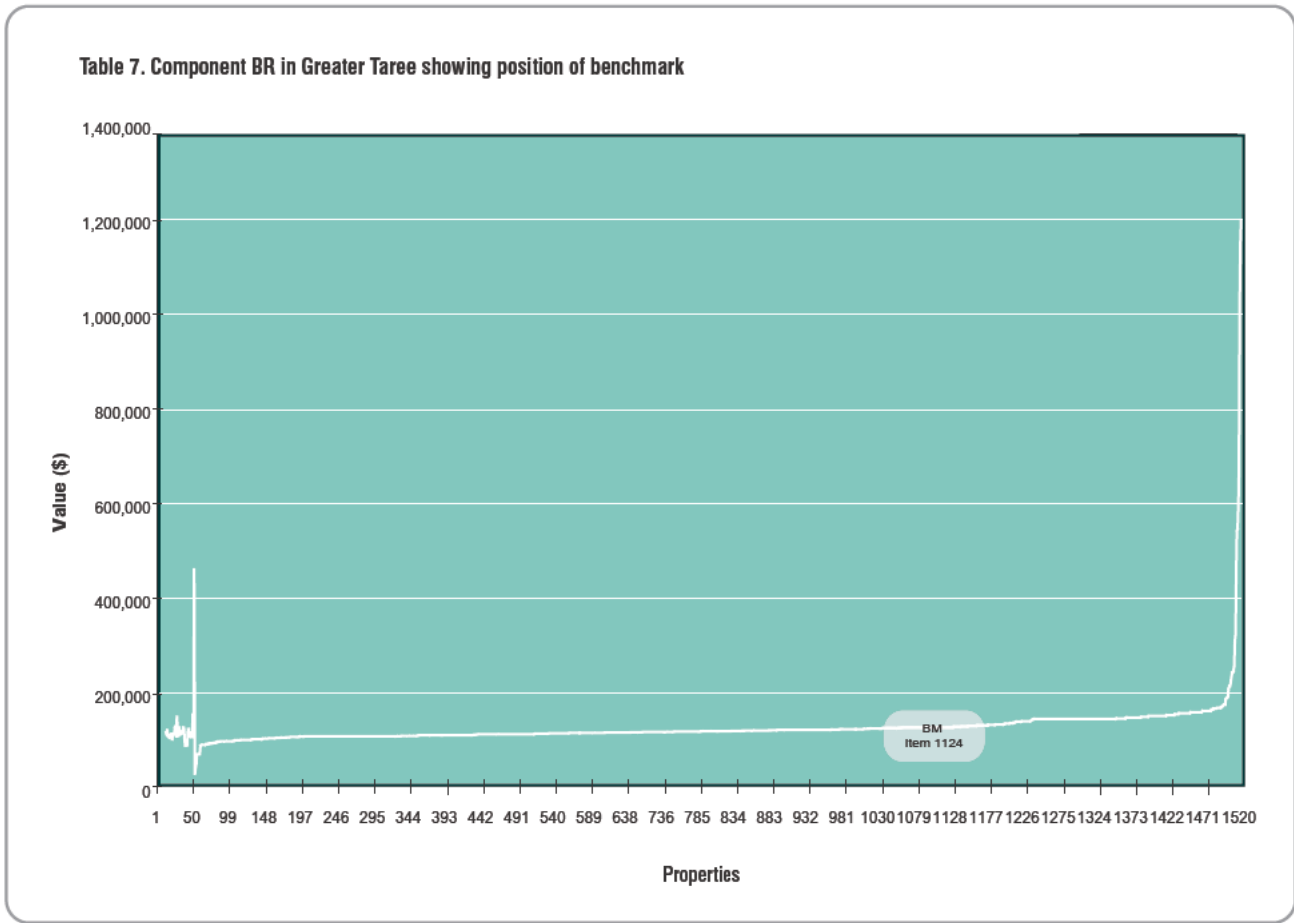
Just as the integrity of valuations derived from the component method of mass valuation is dependent upon the integrity of the allocation of like properties to components, it also is critically dependent upon the selection of benchmark properties that are truly representative of the value movement for the majority of properties in the component.

While the *Procedure Manual for Contract Valuers* says it is generally acceptable to have one benchmark for each component, the manual also advises that “it is necessary to select benchmarks covering the range of major value levels in the component, to check on any variation that may indicate the need for handcrafting or the need to vary the boundaries of a component”. In our review of component data tables for a sample of 90 valuation districts, we found 32 districts were comprised solely of components with one benchmark property. Among the wider sample, the range was from one benchmark per component to nineteen benchmarks in one residential component in Griffith. Districts that used multiple benchmarks did not necessarily have them in all components. Overall there were 1.19 benchmarks per component indicating that the vast majority of components have only one benchmark property.

Given the preponderance to only use one benchmark property per component, one measure of the representativeness of benchmark properties is whether they fall within the middle range of values within the component. Indeed, both the 2003 and 2004 versions of the *Procedure Manual for Contract Valuers* stated that not only should the benchmark fall within the middle range of values, but also that the acceptable standard was that they should be within plus or minus 5% of the median³⁰ value within the component. The median is the middle value in an array of all the values in the component. The version of the procedure manual used in the 2004 valuation program at a later point indicated that where the benchmark did vary more than +/- 5% from the median value, “the benchmark should be checked to ensure it is typical of a significant proportion of properties in the component”.

Some of the contractors have software that enables the graphing of values within a component. The table below is an example of a Greater Taree component showing the 2004 values and the relative placement of the benchmark property in that component which has 1506 properties within it. In this example the benchmark property was valued at \$100,000. The inter-quartile range was \$83,500 to \$103,000 with the median value being \$92,220. While the benchmark in this example was within the inter-quartile range, or middle value range, it was 8.46% from the median value and therefore does not meet the “acceptable” standard laid down in the *Procedure Manual for Contract Valuers*.

Table 7. Component BR in Greater Taree showing position of benchmark



While the procedure manual sets the acceptable standard for benchmarks to be within + or - 5% of the median value, this guideline is not always complied with.

It appears 61% per cent of the residential components on average across the State did not meet the standard. Non-conformance with the standard was even higher in other zones. Table 8 below provides an overall picture of compliance with the standard based on the results from a sample of 90 valuation districts (note: not all districts have all types of zones).

Table 8. Benchmarks not within standard of + or - 5% from median value (sample of 90 valuation districts from 2004 valuation program)

Zone	Total Districts	Total Components in Zone in District	No. of components with benchmark(s) not within +/-5% of median value	% of components not in acceptable range	% in range
All	90	5657	3823	68	32
A Residential	72	1885	1155	61	39
B Business	61	609	507	83	17
I Industrial	65	445	278	62	38

Zone	Total Districts	Total Components in Zone in District	No. of components with benchmark(s) not within +/-5% of median value	% of components not in acceptable range	% in range
P Scenic Protection	34	188	136	72	28
R Non-urban	64	1290	955	74	26
Z Undetermined zone or zone being changed	57	396	287	72	28

The level of compliance/non-compliance is not uniform across the districts. To take a few examples, in the Kiama District, 65 per cent of the benchmarks in the residential zones did not meet the standard; in Greater Taree it was 86 per cent, in Hastings it was 74 per cent; in Waverley it was 67 per cent; in Woollahra 35 per cent and none of the residential components in Hunters Hill, Conargo, Wentworth, Merriwa, Gloucester or Temora met the standard at all. Table 9 below gives a breakdown by zone for some of the districts of focus in our investigation:

Table 9. Compliance with benchmarks standard of + or – 5% from median value – 2004 valuation program – districts of Kiama, Greater Taree, Hastings, Waverley and Woollahra

District	No of components in District	Zone ³¹	Total No of components in Zone	No of components with benchmark within 5% of median	% in acceptable range
Kiama	91	A	26	9	35
		B	12	1	8
		I	1	0	0
		N	1	1	100
		O	3	0	0
		P	20	7	35
		R	19	8	42
		S	7	2	29
Greater Taree	135	A	35	5	14
		B	14	1	7
		I	6	1	17
		O	1	0	0
		P	1	0	0
		R	66	13	10
		S	3	1	33
		Z	9	2	1
Hastings	140	A	50	13	26

District	No of components in District	Zone ³¹	Total No of components in Zone	No of components with benchmark within 5% of median	% in acceptable range
		B	8	4	50
		I	6	3	50
		O	2	1	50
		N	1	1	100
		P	2	1	50
		R	61	11	18
		S	1	0	0
		Z	9	3	33
Waverley	43	A	36	13	36
		B	5	2	40
		S	1	1	100
		O	1	1	100
Woollahra	28	A	20	13	65
		B	5	2	40
		O	1	0	0
		S	1	0	0
		Z	1	1	100

While the component data table reports are provided to contract managers, there does not appear to be any system in place within LPI or the Valuer General's office to perform an overview analysis of compliance with the benchmark standards. Certainly the Valuer General was surprised by these results when he was presented with them:

Q. ...If the standard of plus or minus 5 per cent of the median value is part of the definition of what makes a representative benchmark property, are you concerned that so many benchmarks are outside the standard?

A. Yes, I would be – yes, I would be.

Q. And you weren't aware of –

A. Not to that extent, no – no.

While the above results suggest that there is a serious non-compliance problem with the benchmark standard expected by the Valuer General, the significance of this departure is more difficult to determine.

Essentially, if all properties in a component move in value in the same way, it matters little whether or not the benchmark property falls near the median value or not. However, it is almost impossible to know whether all properties in a component move in a similar way or not without having multiple benchmark properties to test that assumption. In the absence of using multiple benchmarks, the risk of a benchmark not being representative of the value movements in the component increases where it does not fall within the middle value range:

Q. Where you've used a benchmark that is not within the plus or minus 5 per cent of the median value, how can you be sure that the component factor you have derived from valuing that benchmark is truly representative of the movement in value across the whole component and not just the properties that fall in the same quartile as the benchmark?

A. Well, you can't; you can't be sure. The problem with the last two periods is that values have increased substantially. Generally, where there's small increases, you can be reasonably confident that the component factor is representative, but, you know, it could well be that if a different benchmark was selected to comply with the plus or minus 5 per cent that the factor may be slightly different...

...

So essentially, these statistics are still only new and, you know, it's up to all contractors now to strive, I suppose, or to try to achieve a benchmark which is within that plus or minus 5 per cent. It won't always happen, as I say, particularly in regional areas, but that's what our next job is before we commence the 2005 program is to review the benchmarks to make sure they are representative.

[James Tyrpenou, contract valuer, Property Valuation Services, Greater Taree/Hastings districts]

The Chief Valuer also recognized the risk of benchmarks not being representative when their values are not in the middle range of values. In his evidence he stated:

It's a risk management exercise, but because they are outside those measures doesn't necessarily mean there's a problem, but it would be preferable if they were within.... 50 per cent of the properties fall within that interquartile range. That also means 50 per cent fall outside of it, naturally enough, but if the benchmark property is outside that range, I guess there's more risk that it's not exactly representative of those others – not necessarily the case, but more of a risk I suppose is what it comes down to.

The Valuer General also took the view that it was important to work towards benchmarks being close to the median value:

...it would seem to me the closer you can get to that median value in terms of the benchmark, probably from a holistic point of view, the better the result you're going to get in terms of the outcomes from the component.

The origin of the + or – 5% standard appears to be misattributed to the work Professor MacFarlane did for the previous Valuer General in 2002. In his evidence to our inquiry, Professor MacFarlane confirmed that he believed that the + or – minus 5% target may in fact be too stringent, a point of view that was echoed by every contract valuer and contract manager we interviewed:

A. I'm not sure where the "plus or minus 5 per cent" has come from. Certainly, I don't recall in any of the work that I did saying that the benchmark should be within plus or minus 5 per cent. I think I was – well, it is possible in some instances that plus or minus 5 per cent might not even cover the interquartile range. But most of the time, I think it probably would. I'm not sure that I'd made any statements other than that I thought it was probably reasonably important, especially if there was only one benchmark that it was within that interquartile range. In a lot of cases, I would think that this is a more stringent standard than anything that I would have more or less been implying, because I don't think I made any statements other than "interquartile range".

So I suppose out of that, I'd have two questions. One is, is it really important that it's within plus or minus 5 per cent of the median? Yes, it's probably good that it's as close as possible. Is it catastrophic if it's not? Probably not.

In his second consultancy report³², MacFarlane had not in fact recommended a standard of + or –5%. He simply stated:

If the benchmarks are to be representative, one would expect the majority to fall into the middle two quartiles....

Even if benchmark selection is evaluated against a standard of being within the interquartile range, there are still a significant number of benchmarks in use that do not meet this expectation. We found 89 of a sample of 90 districts had one or more benchmarks outside the interquartile range. Of the total components in those districts, 28% had benchmarks not in the interquartile range. Of those non-conforming benchmarks, more than two-thirds were situated within the upper quartile range of values.

According to the Chief Valuer, selection of some of the benchmark properties may possibly date back to the commencement of the use of component methodology in 1992. Certainly, as new valuation contracts were issued, the contractor inherited the existing component structure and benchmarks and then progressively reviewed their suitability. Each of the contract valuers we interviewed confirmed that there had been some changes to components and benchmarks in the previous year but it was difficult to ascertain how extensive any changes were:

Q. ...So did you change any benchmarks in 2004 as a result of the component data table for 2003 showing a number of the benchmarks did not meet the standard?

A. We did. We did. I can't tell you how many, but we did, yes, yes.

Q. So it's just a continuing fine-tuning exercise?

A. That's right, and it's an exercise that, yeah, just continues all the time. You can't say one year that, yes, everything's perfect, because the market changes in different ways, the real estate market changes in different ways. So it's a matter of, you know, reviewing it each year. [James Tyrpenou, contract valuer, Greater Taree/Hastings]

Q. To your knowledge was there any evaluation of the benchmarks used in 2003 and changes made to benchmarks used in the 2004 program?

A. I believe there was. As to the number and which benchmarks there were, I'm not too sure. I may have – I myself – I'm just one valuer within the process but I am the contract valuer over the contract area. I may have taken out one or two benchmarks throughout the components I was looking at because I didn't believe they were relevant but I can't answer for – I can't answer that question for the remaining City of Sydney contract. [Derek Hill, former contract valuer, Quotable Value Australia Pty Ltd, City of Sydney district].

Some contract managers were also sceptical of the time that contract valuers actually devoted themselves to benchmark and component review:

Our best contractors around here are ones that noticeably work 12 months of the year on this work. Most contractors, in my view, do very little work outside of the May to June – sorry, June to October area with a mad panic at September/October, whereas that should be spread across the year, which would solve a lot of these issues. [Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hasting/Greater Taree district]

It is also apparent that some contract managers have not been particularly concerned that the benchmarks used by their contract valuers do not fall within the standard set down in the *Procedure Manual for Contract Valuers*:

...I don't agree with the 5 per cent, I didn't worry about it. I'm not concerned with picking up the 5 per cent. Again, statistics out the door – they might be good, but they are not valuations, and I don't see that there was necessary – that the benchmark should have fallen in that particular place, so I didn't query them more. [Contract Manager Kiama]

It was also apparent from our interviews with a sample of contract valuers that they are not always aware of the value relationship of benchmark properties to the component median value or whether the benchmark falls within the interquartile range or meets the standard in the procedures manual:

Q. Okay. So as you travelled around in 2003 and 2004 valuing benchmark properties in each component, were you aware of where they actually fell in relation to the median value of that component or not?

A. Not specifically.

Q. Okay.

A. It was just my main intention – no, I was not specifically aware of that, but my main intention and aim was to make sure I was grouping lists, making groups of properties. I didn't actually set the benchmarks for all the components but I was making sure I was valuing properties that moved subject to the same market forces, adopting a consistent component for those valuations – for those factors and properties, and then where I had perceived properties were moving at a different rate within that component, I was then going along and handcrafting those properties to make sure that I was still producing consistent, accurate, defensible, responsible valuations. [Anthony Boshel, former contract valuer, Property Valuation Services, Kiama district]

The contract valuer for the City of Sydney district (quoted in 4.6.1.2 above) also was never provided by his employer with the component data tables showing benchmark values and their relationship to the values of other properties in the component to assist his evaluation of the suitability of the benchmarks that he valued each year.

Other contract valuers continued to use benchmarks in the 2004 valuation program that they knew did not meet the standard laid down in the procedure manual because there had been a previous component review conducted by LPI staff where the benchmarks had been found to be satisfactory:

Q. Why have you continued to use those benchmark properties if they do not meet the Valuer General's requirements?

A. Because of the component audit that we had in 2003 which basically said that the components and the benchmarks were okay.

- Q. So you don't change the components without the contract manager agreeing to those changes?
- A. That's right. The new contract manager, and I guess the revelation from this would indicate – or has indicated to him that the changes need to be effected, and we are in that process at the moment.
- Q. Where you have used a benchmark that is not within this plus or minus 5 per cent of the median value, how could you be sure that the component factor you have derived from valuing the benchmark is truly representative of the movement in value across the whole component and not just the properties that fall within the same quartile as the benchmark?
- A. I personally don't see there being a problem. With the checks that we do, any problems would be highlighted. So I don't see a problem with that. But we are not doing what the procedures manual says, so we are in that process of change. [Michael Payne, contract valuer, Crown Valuation Service, Woollahra/ Waverley districts]

Obviously the original selection of benchmark properties would have been done without the benefit of using quantitative measures as a guide. They were generally selected based on the knowledge of the valuers who were working that area and familiar with the nature of the market in those areas. However, the requirement to produce component data tables now gives the Valuer General an objective basis to better monitor and question the suitability of the benchmarks used by contract valuers.

With proper monitoring, one should expect a progressive move to the majority of benchmarks being within the interquartile range over the coming years. Whether this should be achieved by substituting benchmarks or by adding additional benchmarks is a matter for further examination. Professor MacFarlane in his evidence suggested that priority should be given to reviewing benchmarks that had high variations from the median in the first instance but cautioned against wholesale substitution:

You can see there is real potential for the component factor methodology to fall apart if you are changing the benchmarks as often as you're doing the valuations....

My own suggestion would have been, yes, it's good that the benchmark is as close as possible to the middle of your group of properties, but also you probably don't want too many changes of benchmarks, so you should be working towards this over a period of time. Obviously, benchmarks that are a long way outside that range are the first ones you should be getting rid of. But if something was 8 per cent outside, I would have been saying, "Move some of the others first of all, and maybe in time you can come and do that."

MacFarlane suggested that a full review of benchmarks might only be achievable over a number of years.

The quest is for a greater level of confidence in the final values produced by the mass valuation system. Using benchmarks that are both subjectively and objectively representative of the majority of properties within a component is obviously one of the most important ways of shoring up that level of confidence. While most contract managers are drawing contract valuer's attention to the need to review benchmarks that do not comply with the standards set out in the procedures manual, at the moment there does not appear to be any clear system for documenting the outcome of those reviews and assessing whether they are satisfactory or not. As the three examples of component rationalisation between the 2003 and 2004 valuation programs detailed in 4.6.1.2 above illustrate, such changes do not necessarily automatically lead to greater conformance to the benchmark standard or better valuation outcomes. For that reason, it is important that these changes be critically monitored and evaluated.

4.6.3 Benchmark valuations

Benchmark valuation is also a critical element of the component method of mass valuation as component factors are largely derived from those valuations. In valuing the benchmarks, contract valuers analyse and use a broad range of sales to assess the general market movement within the district as well as comparing key sales of comparable land to the benchmark properties in order to determine their market value. The real estate market is said to be 'imperfect' which means that sales generally demonstrate a range of values rather than always being indicative of an exact value. The Chief Valuer gave a good example of this in his evidence:

..., if a property goes to auction, you know, there may be a reserve price that the owner is quite prepared to accept, but if there are two people there who particularly want that property, it may well achieve somewhat more or significantly more than the reserve price. That doesn't mean that's necessarily outside the range of expectations within the market of what that property may be worth, and, likewise, the reserve is probably at the other end of that range of expectations. So there is always this band. As to how tightly that can be defined, that varies from place to place and from time to time, depending on the body of evidence available and the nature of the property.

In using sales information, valuers therefore will give greater or lesser weight to some sales depending on their assessment of where that sale generally fits into the market range. In some cases, they will discount sales completely if they have evidence that the price paid is not market related. This often happens with sales to adjoining owners or sales within families or commercial entities that may involve either significant premiums or discounts and are not representative of prices that would be achieved in an open market.

This means that the valuation of benchmark properties necessarily has a degree of subjectivity that is a characteristic of all valuations.

The *Procedure Manual for Contract Valuers* also notes that the valuations:

- must have regard to the purpose of the valuations for rating and taxing;
- must be consistent with the market on a both a local and state-wide basis; and that
- any variations above or below a reasonable relationship to the market as indicated by the sales will not be accepted.

In determining the component factor, contract valuers are cognisant of these issues and may either apply the benchmark factor or a slight variation depending upon their level of confidence in the representativeness of the benchmark property and the degree of homogeneity of properties in the component. As the values are produced for rating and taxing purposes, it appears to be standard industry practice to take a conservative view of the market and to resolve any doubts as to the appropriate level of values in favour of the rate or taxpayer.

In terms of valuation of benchmarks this sometimes leads to what appear to be anomalies.

4.6.3.1 Benchmark valuations differing from deduced land value from actual sale

For example, in reviewing the 2004 Kiama component valuation report, we discovered several benchmark properties that had been sold but benchmark valuations were substantially different from the adjusted analysed land value derived from the sales price. These appear in table 10 below:

Table 10. Examples of benchmark valuations that vary from sales evidence – Kiama district 2004

Property No	Component	Adjusted analysed land value deduced from sale	Contractors valuation at 2004 base date	Factored land value (after applying component factor to previous valuation)
1027620	BP	\$1,500,000	\$1,000,000	\$750,000
1026453	DK	\$700,000	\$640,000	\$630,000
1028181	GX	\$285,000	\$260,000	\$226,000
1024659	JB	\$640,000	\$550,000	\$538,000

The contract valuer when asked to explain these discrepancies gave the following evidence:

...in actually valuing a component I am trying to get a fair and reasonable, accurate valuation for the whole of the component. I may have felt at the time that the actual sale price and analysed land value may – I might have felt the sale price did not actually represent the true value in the area, having regard to the other sales evidence that I had and I had to make a value judgment on that. I think with North Kiama Downs the sale price was 398,285 and I adopted 260 as my value at base date. North Kiama Drive is a busy road. I think with my valuation in that I possibly thought that the people had paid a little too much for the property they purchased and the reason why the factored land value came down was with the factors, the component factor that I used was more based on the other benchmark properties – on the other sales properties, I beg your pardon, and the other benchmark properties and for that reason I adopted a lower factor than what showed on the North Kiama Drive factor. But the basic reason why I had a lower deduced land value than the sale price would have indicated was I think because I thought that the property was possibly too high – the sale price was possibly too high.

Q. Is that an unusual thing or is it quite common?

A. Oh, I think it happens. It's probably part of our job that we have to go along and have a look at all the sales and make our own value judgment as to whether people have paid a correct price or an above market price and for that reason that's – it's up to us to make a value judgment, which is definitely an inexact science,

but I mean we can only go on the quantum of the sales, the whole majority of the sales, in making our valuations and then in that particular case I must have considered at the time that it was a bit above what was being paid for comparable properties in the area. [Anthony Boshel, former contract valuer, Property Valuation Services, Kiama district]

The contract manager for Kiama gave evidence that he would generally expect the valuation of a benchmark property to be the same or very near an adjusted analysed land value if it was property that had been sold and there was available sale evidence of its actual market value. He believed the variations in these examples were too extreme:

[the first property] *...I think that the \$500,000 difference is a very poor oversight on their part, and I would have thought that the valuer who did the benchmark valuations... should have picked that up straight away³³....*
[the discrepancy] *It shouldn't exist at all.... I think if his explanation was that it was an out-of-line sale, there should have been a comment in here saying that in that very comment, but it doesn't say that here at all.*

...

[the second property] *I probably would have expected them to be closer than that. I would-if there was 10 or 15,000 difference, I would say that was okay, but in a situation where this is actually \$60,000, I think that's a bit far apart still, too, because I could understand that you'd have a difference -if you've got an analysis that you've done on a particular day and you've come up with some \$700,000, when you come to actually make the valuation, I think you would be somewhere near the mark. You know, you might be within a few per cent of where your analysis was ...you might say "well, its not really worth 700, because I've got a couple of other sales now that I didn't have when I was analysing them, but now when I'm coming to compare them, its not really worth 700, but, you know, its got to be somewhere nears the mark, so it might be 675 ...I would think that you'd be within maybe 10 or \$15,000, you might stretch it to 25 in the higher number...*

...

[the third property] *I'd say for residential property I'd say that was well and truly too far out too.*

...

[the fourth property] *640 to 538 -that's too far again. You see, that's \$100,000. That's a residential property... That's ridiculously different. [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]*

In fact, the contract manager had audited the component valuation report for component GX and had identified the discrepancy between the adjusted sale price and the benchmark valuation. He had emailed the contractor saying 'the analysed land value is higher than the land value adopted for the benchmark value -the benchmark should be reviewed'. He was not able to say whether he received a reply however.

There are circumstances, however, where it is totally defensible to value a property at a different level to that deduced from an actual sale and that is where the valuation is made having regard to the totality of the market for like properties. As the Valuer General said in his evidence:

In the majority of circumstances I would expect in actual fact that they [the benchmark valuation and the adjusted land value from the sale] probably wouldn't be the same -...this is one particular sale in a potpourri of sales. The valuer obviously in analysing the market is looking at the total market within either that component or in the breadth of comparable properties that are available. When that particular sale is placed into that pot, there can be a different answer achieved in relationship to that particular property, and I make the analogy here, if I - I could almost guarantee to you if I got 10 different buyers to look at a particular property and said, "What are you prepared to pay for this property today?", I would almost invariably get 10 different answers as to what people would be prepared to pay for it. That's simply because they have all got different views in terms of what they expect from that property, in terms of their own personal circumstances or dislikes or likes in relationship to a property. It's the same with a valuation. You'll never get, or almost never get, 10 valuers saying specifically, "I think this property is worth \$1 million today." They might say 950, they might say 900 - you know, there's a degree of - based on how they have analysed the sale. I mean, valuation is not an exact science. You know, there is a degree of judgment based on that, and my belief is that, you know, that's the situation that occurs here in relationship to these. In fact, I guess I would be - this is from my experience - I would be slightly perturbed if I in fact found out, going through here, that they all were the same.

It appears that the examples detailed in Table 10 above may not necessarily be the type of examples the Valuer General was contemplating in the above quote. Those benchmarks in fact produced factored land values substantially below either the adjusted analysed land value deduced from the actual sale or the benchmark valuation of each of these properties. This certainly raises the question of their suitability as benchmark properties.

Relatively few benchmark properties are sold and so produce objective evidence of their 'real' value. Assessment of the quality of benchmark valuations therefore relies upon contract managers examining component valuation reports and using the limited information available in them to make an assessment of the reasonableness of the benchmark valuations. As there appears to be no calculations provided for the valuation of benchmarks, particularly for residential zoned benchmarks valued on a comparative block basis, this oversight is practically limited.

4.6.3.2 Examples of applying handcrafted values to benchmark properties

While each benchmark is individually valued, the practice is to apply the component factor to the benchmark to determine the issued valuation so that they are treated like the majority of properties within the component. To do otherwise would potentially lead to the breakdown in the methodology if benchmark properties were assigned values differently to others. In our review of Market Analysis Reports for both the 2003 and 2004 valuation programs in the Kiama district, we discovered that 26 benchmark properties had issued valuations for 2003 that were not derived from the application of the applicable component factor. In 17 cases the actual value increase was greater than the adopted component factor. In 9 cases it was less. In 21 of the 26 the issued valuations were also different from the contractor's assessed benchmark valuation that appeared in the Component Valuation Report. Approximately half of the benchmarks were in commercial components or other components where properties are usually handcrafted, but the others were not.

As part of the investigation, we required Property Valuation Services to account for this. The explanation provided was that the final 2003 values for most of these benchmark properties were handcrafted. The explanation went on to say:

The valuer that completed the valuations advised me that he adopted this method of valuation because the component factor that existed did not produce the correct answer for the majority of the properties. He then proceeded to handcraft a significant number of properties in each of the components so as to try and ensure that the values were correct. The number of handcrafted properties varied from 1 out of 2 properties in component DK to 234 out of 316 properties that were in component GA. In components BG, BL, BN, CZ KA all of the valuations were handcrafted. It is not common for approved component factors not to be applied to benchmark properties. In this instance the contract valuer that worked for Property Valuation Services does not remember providing the Department of Lands Contract Manager with the amended SVO Component Report sheet but now realises this should have been done.

The failure to document these changes meant that there is no audit trail to justify these departures from the standard practice. Had reports been made, it presumably would have prompted the contract manager to request a review of the composition of some of the affected components and the suitability of the benchmark properties. This apparent problem in using the component factor in these components to produce the right values was, however, not repeated in the 2004 valuation program when all the benchmark properties appear to have had the component factor applied.

4.6.4 Component factors

The *Procedure Manual for Contract Valuers* describes the process by which component factors are derived. This is simply calculated by dividing the new valuation of the benchmark by the prior issued value of the benchmark. The resulting factor worked out to two decimal places is then applied to the component. The manual does allow for exceptions however. It states:

It is expected that there will be little variation between the component factor calculated and the adopted factor. Where there is any variation the reasons for the variation should be provided.

If a number of benchmarks are used, the manual states that the "component factor selected will be the one that gives the correct result for the greatest number of properties. A wide variation of indicative factors following valuation of the benchmark properties may indicate a need for sub-component factors or the creation of new components".

Some contract valuers appear to strictly apply the factoring methodology detailed in the procedures manual with approved component factors rarely if ever departing from the benchmark factor. Some contractors, however, adopt component factors that are more variable.

As the component factor is defined as the factor that will bring the majority of properties up to the correct value, consideration has to be given as to the relative relationship of the benchmark to the majority of properties taking account of a number of issues that affect component composition:

these valuers are out there doing their best in what is a quite difficult environment to try and come up with everything to fall into place, you know. They are not only thinking of the valuation of the benchmark, they are thinking of that poor little block down the road that sold for only \$500,000 when everything else around it was selling for \$1m. They have all these things in the back of their mind and they are trying to make that component also match the next component; they don't want to get alignments out.

They are trying to keep gradings within the component accurate. It is just a moveable feast trying to get these things all to gel, and then to expect it all to come out on paper and every sale to match, you know, the same increase as the benchmark is just unrealistic. That's just not going to happen, for a variety of reasons. [Michael Parker, District Valuer, Sydney East, contract manager Woollahra/Waverley]

In our review of a number of focus districts we found evidence of a number of practices that departed from the basic methodology of adopting the benchmark factor as the component factor, two of which resulted in component factors being more conservative than the benchmark valuations would otherwise indicate.

4.6.4.1 Adoption of 'rounded down' component factors

In the Kiama district in the 2004 valuation program, the adopted component factors in 87 of the 91 components was less than the single benchmark factor they were based upon, or where there was more than one benchmark property in the component, was less than the lowest benchmark factor.

Four of these adjustments were significant, as high as 50% variations, however, they occurred in components where most if not all properties were handcrafted so it was immaterial³⁴. In all the other cases, the component factors appeared to be rounded down to the nearest multiple of 5%. Examples of variations between benchmark and component factors for the residential components in Kiama are provided in the table below:

Table 11. Variations between lowest benchmark factor and component factor – examples of residential components Kiama 2004

Component	Benchmark factor	Adopted component factor	Reason provided (verbatim)
EB	1.07	1.05	Well-kept suburban area. Sales evidence shows demand still evident in market. The benchmark was valued by direct comparison with sales. Handcrafting undertaken as required.
GA	1.08	1.05	Older established area in close proximity to Werri Beach. Properties not in Renfrew or Werri Streets in line with Comp GD. The benchmarks were valued by direct comparison. Values at Werri Beach show higher increases and increased by factor of a.25
GB	1.30	1.25	Well-located area across road from beach. One sale only in component shows continuing demand. Sales from Comps GA, GX used as supporting evidence. BM valued by direct comparison.
GD	1.07	1.05	Good residential area close to beach. Sales evidence shows continuing demand. Sales from Comps GA used for Wilson Ave (east side location). BM valued by direct comparison. Handcrafting where necessary
GK	1.12	1.10	This is an attractive residential area and shows continuing demand. Recent sales show strong demand. BM's valued by direct comparison. Handcraft where necessary.
GL	1.18	1.15	Superior component in excellent location. BM valued by direct comparison. Handcrafting has been undertaken in Headland avenue
GM	1.16	1.10	Strong demand evident in Gerroa. Significant increases noted. BM's valued by direct comparison. Sales from Comp GK used as supporting evidence. Handcrafted where necessary, particularly around Headland Drive.
GS	1.14	1.10	Quality location, which is in high demand. Sales evidence shows strong continuing demand. BM's valued by direct comparison. Handcrafting as necessary.

It is noted that in none of the above or other examples found in the Component Valuation Report was there an adequate explanation for why the approved component factor differed from the benchmark factor as required by the *Procedure Manual for Contract Valuers*.

The contract valuer was questioned about these variations and gave the following evidence:

Q ... The approved factor that you applied to the component was generally less in every case to the factor you put on the benchmark property.

A. Yes.

Q. Why was that?

A. Why was that? In a lot of – in a lot of cases it's a – in my valuations I tend to round down because I find it hard to say that I'm accurate to 1 per cent or 2 per cent or 3 per cent, so I tend to round down my valuations only to the degree that I still consider they represent the market and that they are accurate valuations and that they are defensible valuations. I think the majority of these seem to be within a fairly narrow range where they've just been rounded down to 1.0 from 1.12 or 1.15 from 1.8. There are a few significant ones, but in general I attempt to value to the market and I felt – I was aiming to achieve consistency with my valuations and I felt by adopting the land tax factors that I did I would produce accurate consistent valuations within the area.

Q. Why would rounding down 1, 2 or 3 per cent provide valuations that are any more consistent than applying the actual benchmark factor?

A. When you're valuing a large number of properties and the benchmark factor is applied to a particular property, I would think my rationale for that would be possibly to resolve any doubts in favour of the owners in trying not to overvalue their properties and that would be the main reason I would do that. I notice there are some significant ones here and in that case I considered the benchmark factor too high in that particular property to represent the particular component. [Anthony Boshel, former contract valuer, Property Valuation Services, Kiama district]

The Chief Valuer was asked during the inquiry whether this was a widespread and approved practice:

A. Is it a widespread practice? I think I suspect it probably is. Is it approved? Not in a formal sense – it is not written down as something to do, but I can understand why valuers would do it. Given, once again, as I said, valuation operates within the constraints of an imperfect market, to write a valuation to within 1 or 2 per cent is pretty fine judgment, I think. I can see that in a strictly systematic sense, you know, it's probably preferable that the factor adopted be exactly the same as the factor demonstrated by the valuation of the benchmark, but in these circumstances where you are talking variations of a couple of per cent, I don't think that's a significant problem.

Apart from the fact that Valuer General expects contract valuers to value as close to the market level as reasonably possible, the practice of rounding down over time necessarily does have a minor undervaluing effect. Table 12 below provides an example of the effect of rounding down over five years using the data from component GS Kiama.

Table 12. Hypothetical effect of 'rounding down' a benchmark factor using median land value component GS Kiama over five years

Year	True value ³⁶ (14% increase pa)	Benchmark factor ³⁶	Rounded down component factor	Assigned valuation	Percentage error
2004	324000			[324000]	
2005	369360	1.14	1.10	356400	3.5%
2006	421070	1.18	1.15	409860	2.7%
2007	480020	1.17	1.15	471339	1.8%
2008	547223	1.16	1.15	542040	0.9%
2009	623834	1.15	1.10	596244	4.4%

Any undervaluing resulting from the rounding down of component factors is partially self correcting over time due to the fact that benchmark factors are derived by dividing the new 'true value' (arrived at by the application of the traditional valuation methodology) by the previous assigned valuation (produced by the application of the previous year's component factor). As table 12 demonstrates, the impact is not cumulative but varies from year to year and the rounding error never exceeds 5% in any year. In some years the benchmark factor exceeds the 14% assumed increase, as do the 'rounded down' factors. When the assigned value is low in comparison to the 'true' value in some years, it is partially corrected in following years in a cyclical fashion. However, the practice still has a marginal undervaluing effect that can have implications for rating and taxing. For example, if the above hypothetical benchmark was a property subject to land tax, the shortfall in land tax revenue payable on the property over the years 2006-2010 as result of this rounding down practice would be \$1115 according to current rates.

The greater concern is that it introduces an element of inconsistency in the valuation practice across the state. It is not known how widespread the rounding practice is. As the practice of rounding down component factors introduces a further variable that can affect the accuracy and reliability of valuations, it should be discouraged.

4.6.4.2 Adoption of conservative component factors

In the Greater Taree and surrounding districts, we discovered a different and more worrying practice. In many components the variation between benchmark factors and approved component factors was far more significant than simple rounding down. A selection of components from the Greater Taree Component Valuation Report appears in Table 13 below and provides examples of this practice:

Table 13. Variations between lowest benchmark factor and component factor — sample of residential components Greater Taree 2004

Component	Benchmark factor	Adopted component factor	Reason provided (verbatim)
AA	1.57	1.43	Benchmark – block value -\$220,000. The market evidence inferior to the benchmark. The benchmark enjoys good views over the Manning River to the surrounding rural area. Factor of 1.43 to apply to whole of component.
AC	1.83	1.67	Benchmark – Block value -\$110,000. Adopt a component factor of 1.67. Factor to apply to whole component.
AD	1.66	1.50	Market evidence supports a block value of \$130,000. A factor of 1.50 has been applied to the whole component.
AF	1.84	1.69	Market evidence supports a block value of \$120,000. A factor of 1.69 has been applied to the whole component.
AH	1.85	1.72	Benchmark –Block value -\$130,000. Adopt a component factor of 1.72. Factor to apply to whole component.
AJ	1.69	1.54	Benchmark –Block value -\$2320,000. Factor of 1.54 to apply to whole of component.
AN	1.35	1.20	Market has increased since last base date. Benchmark valued as a single dwelling site. Factor applied to whole component.
BE	1.33	1.20	Increase required for land in this component. Benchmark valued as a single dwelling site. Factor applied to whole component.

As noted from the comments section of this table, there was no apparent reason provided for why the adopted component factors differed so greatly from the benchmark factors. By analysing the complete factor table we were able to determine that in most cases the component factor was arrived at by reducing the benchmark factor by 10%. James Tyrpenou, the contract valuer enlightened us as to how and why this happened:

But essentially what we were instructed to do, we were instructed to value the benchmark at the correct value right – say, for example, the benchmark is valued at \$200,000 – but then to adopt a factor which arrived at 90 per cent of that value, not 100 per cent. So we were instructed – or not instructed, advised to adopt a factor which would arrive at a value of 180, not 200.

Q. Was explanation given for that?

2A. Oh, yeah, basically because they wanted to – I'll give you a copy of this. It's:

The Valuer General has revised the MVP standard for 2004 year. The standard for the mean variation of analysed value to land value is now 90 to 100 per cent³⁷. It is preferred that the contractors adopt a level of value at the bottom end of the statistical range to ensure a result as close to 90 per cent as possible.

The quote is from a letter from the Newcastle Regional Valuer dated 13 May 2004 to Property Valuation Service's Regional Valuer at Taree. According to the District Valuer at Newcastle this came about due to concerns generated from objections in the previous valuation program that indicated that the contract valuers were "right at the market and, in some cases, above the market".

When the proposed factors for the first contract district (Gloucester) were delivered in 2004, they realized that in some cases they would generate land values that were also above some of purchase prices on some of the sales used to value the benchmarks. In comments sent back to the contract valuer, the contract manager included the following comment for five components:

The proposed factor will result in values being at the top end of the market range. A value at around 90% of market levels would provide some buffer to account for different properties within the component.

A meeting was subsequently held with the contract valuers on 9 September 2004 at the Property Valuations Services office at Taree attended by the Regional Valuer and Contract Manager at which a number of issues relating to the 2004 valuation program were canvassed. Minutes of that meeting indicate that the method by which the 'buffer' should be dealt with were discussed:

5. *Bruce [the Regional Valuer] stressed the need to look at the results that will flow from the adoption of a proposed factor over the whole of the component, not just the benchmark.*
6. *The need to be at the lower end of any market range was discussed, particularly in reference to the proposed residential factors in Gloucester. Andrew [one of the contract valuers] asked what was the most appropriate means of addressing this issue within the framework of the existing component reporting. It was decided that the benchmark should be valued in comparison to the available sales evidence and that any adjustment required to better reflect the lower end of the range, or variances of property within a component, be acknowledged within the actual factor proposed*

The contract manager gave evidence that in areas where there was limited sales evidence it "was an attempt to try and reign in, if you like, our contractors from operating –banging their heads against the top of the market, which in my view, was what happened a bit last year-the year before". His expectation was that the valuations would be "more easily defensible" as a result of the process:

...we had meetings with all the contractors at the start of the program and the start of the program was, "We do not want to be in a situation where we are going out looking at objections and having immense difficulty justifying the value levels that are being put on properties. We don't want to be at 100 per cent of the market value"... in an ideal world they all should be right. Well, they are never going to be right, no matter what happens. They are not all going to be right, but you know, to the-we prefer to be right on the underside of them than right on the overside of them [Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hastings/Greater Taree district]

He believed however that the direction " was taken to a degree that it wasn't supposed to be taken".

In fact, the Property Valuation Service valuers who attended that meeting went off to value their respective districts and appear to have implemented the direction with some discretion. While on average the component factors in Greater Taree were 10% below the benchmark factor, in Hastings for example, the undervaluing was more like 3%.

The Valuer General was not aware of this instruction and was critical of its issue:

No, I wasn't aware of it and, secondly, it would concern me if that was the case... I would never have expected something like this to have been issued. [Valuer General]

Similarly, the Chief Valuer was also critical and indicated that the practice illustrated what he considered to be role confusion on the part of LPI officers:

...I wasn't aware of this, and, yeah, it does concern me somewhat, I have to say...

...

THE ASSISTANT OMBUDSMAN: Q. Now that you know about it, what are you going to do about it?

A. Well, probably it won't surprise you to learn that I'll be getting on the phone when I get back to the office and speaking to the regional valuer about it. I think that – as I said, we're actually doing quite a bit of work about trying to clarify these roles, and I think that will certainly assist in these sorts of things, in that what – as I think I described the role as I see it of the contract manager is one to be satisfied, if you like, that the values that the contractors are writing are reasonable. Rather than directing the contractors to write certain values, it's about questioning areas of doubt to be satisfied.

Whilst the practice of applying a conservative component factor in areas where there is little sales evidence is defensible as a valuation practice³⁸, the major concern of practices such as this being applied in some valuation districts but not others is that it undermines the consistency of the valuation process across the state. From a rating and taxing perspective, it could imply that government bodies are short changed in these districts because of systematic undervaluation.

4.6.5 Data integrity checks

LPI redeveloped the Valuer General's data base program Valnet in April 2001 and consolidated a number of separate local systems and incorporated a substantial value checking module. When contract valuers deliver the electronic value file to the contract managers, the managers are responsible for running a number of integrity checks to identify problems with and the acceptability of the proposed values using this system.

The Valnet system has two main value checking modules. The Data Integrity Checks module incorporates a number of systematic checks of valuation data as the user loads it onto the system or on an ad hoc basis on request. It includes 28 functions for checking contractor supplied land values, concessions, components, benchmarks and sales analysis for a specified district and base date to ensure compliance with legislation and validation rules. Data integrity checks include for example tests that will identify properties with blank land values, the use of invalid component codes, missing component factors, components without benchmarks, benchmarks without linked sales and duplicates.

The Value Analysis Report module also enables contract managers to undertake a variety of tests that compare values to sales and analyse allowances and concessions. For example, the factor range report can be used to identify anomalous properties where the proposed value may be greater than a specified factor range. The variation by concession report can be run for all concession types to check results for consistency across the district. The variation by land value report can be used to identify high-risk properties with significant values for checking.

Errors identified through the data integrity checks are referred back to the contractors for review and rectification and changes then made manually or through the importing of a new updated values file. In such cases, the data integrity checks are run again and the process repeated until such time as all checks are satisfied.

While the *Rating & Taxing Valuation Contract Management Procedures Manual* requires contract managers to run some specific parameter check reports under the Values Analysis Report module, they are given discretion as to the appropriate parameters to apply, whether some of the checks are done on a whole district or zone or component basis.

The values are 'signed off' in accordance with Valuer General's delegations once all values are provided and the required checks are considered satisfactory. Valnet operations are then locked and the values applied. Contract valuers cannot thereafter change those valuations.

Our review of a sample of district files found that these integrity checks were generally conducted in accordance with the procedures manual requirements. The extent of value analysis checks undertaken using the Values Analysis Report module was, however, largely dictated by the time constraints that contract managers had, especially where they were responsible for monitoring the progress of numerous districts. The time period between receipt of value files and deadlines to accept values is quite small and most of that time is taken up in resolving the more simple data integrity checks. Not surprisingly, there is little indication that extensive discretionary checks are made using the functionality of the Values Analysis Report module of Valnet. This is of some concern given that these are potentially some of the most valuable checks to identify problems with the actual proposed values.

4.6.5.1 Development of new values analysis tools

During the course of the investigation, LPI was engaged in a significant software development project to develop an integrated mapping module for Valnet called "Valmap". Among other things, the system will provide the ability to select and identify properties and land parcels for the display of specific attributes, provide the ability to calculate property areas/dimensions, enable information or ranges of information to be selected, labelled and coloured from tables of particular data sets, and enable layering of topographical data, aerial photography and remotely sensed

imagery. Valmap is being developed in two strands –an on-line version primarily for use in the maintenance of the Register of Land Values and a stand alone version for contract managers and contract valuers.

It is expected the ability to visually map Valnet data will better highlight potential problem areas for both LPI contract managers and contract valuers and therefore bring about greater efficiencies and quality control in the regulation of the valuation process. This in turn is hoped to lead to improvements in the accuracy of the valuations provided which in turn may lead to reductions in objections. The system should also assist improve objection processing time through the system's ability to identify subject properties and locate and map relevant supporting sales evidence. The stand-alone version has been developed to an advanced prototype stage and was expected to be released for testing by the end of August 2005.

4.6.6 Check valuations

Apart from the use of statistical measures (see 4.6.7 below) to see how closely assigned values correlate with market evidence of values, the major quality assurance check for the accuracy of valuations is by undertaking check valuations. This is where an independent valuer conducts a re-valuation of properties valued by the component method using the traditional valuation method.

Independent check valuations were originally introduced on the suggestion of the Land Valuation Specialist Advisory Group (LVAG) in 2002 during the tenure of the previous Valuer General. They were carried out in six districts by three firms of private valuers selected by the LVAG. It was subsequently reported to the LVAG that overall the results from these valuations concluded that while there were variations in approach to completing the valuations and the sales evidence available (due principally to timing of the check valuation exercise and the prior completion of the general valuation), the check valuations and the valuations recorded in the Register of Land Values were within acceptable parameters.

As part of the investigation we obtained the original reports of the check valuations. A fair reading of the reports raises some doubts about whether it could be concluded that the check valuations indicated that the valuations recorded in the Register of Land Values were within acceptable parameters. They in fact revealed some significant discrepancies of valuation opinion:

- Check of 82 residential valuations Marrickville district: 17 valuations were the same or less than the issued valuations, 4 were up to 15% above, 26 were 10-20% above, 29 were 20-25% above and six were more than 25% above the issued values. The check valuer however had a number of more recent sales available to him that indicated a 10-15% rise relating to the market data used by the contract valuer.
- Check of 11 commercial and retail valuations City of Sydney: the check of each property valued it higher than the valuation issued by the Valuer General – the increases were respectively of 6%, 15%, 16%, 19% 33% (two), 37%, 50%, 55%, 72% and 80%.
- Check of 9 industrial valuations Ryde district: four of the check valuations were 4-6% lower than the issued valuations and 5 were 9-17% higher.
- Check of 12 retail centre sites North Sydney district: Working off the same sales data, the check valuer valued 8 properties within +/- 2% of the issued valuation, and valued the remaining four properties 6-8% below the issued valuations.
- Check of 14 industrial valuations South Sydney district: again using the same sales information as the original valuer, the check valuer valued six properties within +/- 3% of the issued valuations, six 4-6% above, one 16% above and one 40% above the issued valuations.
- Check of 74 residential valuations Randwick district: using some more recent sales in a rising market that meant that the check valuations were expected to be higher given the timing of the exercise, the check valuer valued six properties less than 30% greater than the issued valuation, 58 were 30-40% greater and ten check valuations were more than 40% greater than the issued valuations.

There were no check valuations done in the 2003 valuation program. The Chief Valuer and Valuer General were both appointed late in that year when the valuation program was in an advanced state and no previous arrangements had been made for check valuations. According to the Valuer General due to timing and resource issues, no check valuations were conducted for the 2004 program either.

While he had not examined the individual reports mentioned above, the Valuer General was critical of the methodology used previously. He favours parallel check valuations rather than *post facto* check valuations so that the results can be available to contract managers prior to their approval of the valuations submitted by contract valuers. At the time of the investigation, the Valuer General had advertised for expressions of interest to conduct a program of check valuations for the 2005 valuation program and envisages the regular and continued implementation of check valuations will further assist in the quality assurance process in future years:

I think it's really, really important that we do have some form of independent checks undertaken. It's the same as any normal audit procedure. While there's a whole lot of other checks and balances in there, I think fundamentally you've got to get back and have a look at actually what's being produced in relationship to, you know, getting some comparisons with other valuers working in the area as to what's going on. So, once again, it's just another tool to put in place in terms of the process to ensure the quality of the valuation outcomes and again to give me some confidence that the answers we're getting, you know, once again, can stand up to scrutiny from an independent point of view. [Valuer General]

The project of check valuations for 2005 is being overseen independently of the Valuer General by a working group of the Land Value Advisory Group. Locations selected are: Tamworth Regional, Byron, Dubbo, Wyong, North Sydney, Kuring-gai, Woollahra, Sydney CBD, Fairfield, Sutherland and Wollongong. For regional locations random properties have been selected for the following property types: rural-non-urban, commercial, industrial and residential. For metropolitan locations (including Wyong and Wollongong) random properties representing the following property types have been selected: medium density-mixed use, commercial, industrial and residential. In the Sydney CBD, properties were selected by the working group to cover a range of locations and property types. Independent valuers not involved in the 1 July 2005 mass valuation program are undertaking the parallel valuations. They are required to be completed by 31 August so they can be reconciled with the valuations being produced by rating and taxing valuation contractors.

It would be appropriate for the Joint Committee on the Office of the Valuer General to review the results and implications of these 2005 check valuations as part of their general overview of the methodologies employed for the purpose of conducting valuations under the Valuation of Land Act.

4.6.7 Statistical measures of accuracy and uniformity

In order to display equity and to be supportable during challenge either through the objection process or during court appeals, valuations need to be accurate and uniform. Prior to the introduction of the premium property tax and the changes to land tax in the 2004/05 period, consistency of valuations tended to be of greater relative concern. Particularly for land owners not subject to land tax, given that rate capping has been in place for many years in NSW, the principal concern about valuations was to ensure they were uniform and that no group of people were having an undue burden placed on them in terms of the rates that they would pay due to inconsistent valuations between properties. With the advent of the premium property tax, and the abolition of the land tax threshold in 2004/05 that extended land tax liability to hundreds of thousands of extra landowners, the accuracy of valuations has become significantly more important.

Apart from check valuations (see 4.6.6 above) and the reviews that come by way of the objection process and Land & Environment Court appeals, the principal objective quality assurance measures to determine the level of accuracy and uniformity of valuations are statistical measures. While there are a number of statistical measures mentioned in various standards, the Valuer General has adopted a number of measures, three in particular – the coefficient of dispersion, mean value price ratio and price related differential – which are commonly used in mass appraisal systems around the world. The requirement on contract valuers to provide these statistical measures at the time of submitting their proposed values is, however, a recent initiative and has only been included in contracts issued from 2003 onwards.

Only 13 contract areas were required to produce statistical reports for the 2003 base date. Those contract areas were Canterbury/Bankstown; Deniliquin; Griffith; North Harbour; Nyngan; Outer Harbour; Penrith; South Coast; St George/Sutherland; Taree; Queanbeyan; Upper North Sydney and Warringah. Contracts issued in 2004 also required their production for the 2004 valuation program and from the 2005 valuation program onwards, every contract requires them.

To enable an insight into the level of accuracy and uniformity of the valuations produced in the 2004 valuation program, we were able to examine the statistical results for a sample of 90 districts across the state where those reports were required by contract or were otherwise available and compare the results against the standards expected by the Valuer General. The analysis and comments appearing in the sections below are based on that data.

4.6.7.1 Acceptable standards of valuation accuracy

The complainant has argued that if the component method of mass valuation is working well, it would be expected to produce land values within 10% of the market value³⁹. This appears to be an expectation of precision that is unrealistic according to much of the international research and standards on acceptable margins of error.

The courts have long recognised that valuation is a matter of professional opinion and more akin to an art than an exact science⁴⁰. Consequently they do not expect a valuer to accurately pin point the correct valuation, however, through the concept of margin of error they have sought to apply some boundaries of acceptable practice. Neil Crosby, the Professor of Land Management at the University of Reading UK in a recent paper⁴¹ summarises a number of empirical studies of the relationship between sales prices and valuations that address the margin of error issue.

These include:

- Drivers Jonas/IPD 1997⁴² – an analysis of 8500 transactions found the number falling with +/- 10% was 30%, the number falling with +/- 20% was 67% and 33% fell outside that bracket.
- Matysiak & Wang 1995⁴³ – an analysis of 317 transactions found the absolute average error was 16.7%.
- Blundell & Ward 1997⁴⁴ – an analysis of 747 properties found only 35% of the valuations were within 10% of the sale price and 20% were more than 20% different.
- Parker 1998⁴⁵ – an analysis of seven commercial and industrial properties found valuations differed from sale prices by an average 7.7% ranging from 14.3% below to 8.8% above.
- Newell & Kishore⁴⁶ – an analysis of 101 office and 117 retail properties in Sydney found an absolute average absolute difference of 9%.

Crosby also addressed studies of valuation variation (ie. the variation in valuations made by two or more valuers of the same property) which again indicate that margins of error can be quite high:

- Hutchinson et al 1996⁴⁷ – a study of up to ten valuations of the same properties, found the average variation of rack rented properties was 10.5% with 39% outside + or - 10% and 15% lying outside the + or - 20% parameter.

Crosby also examined valuation negligence cases in the UK that illustrated that the normal margin of error applied by the courts is between +/- 10% and +/- 15% rising to a maximum of +/- 20 % where the valuation is considered difficult⁴⁸.

In a more recent paper that examined variations in valuations provided by expert witnesses in both Australia and the UK, Crosby, Kincaid, Murdoch & Lavers (2001)⁴⁹ reported that a comparison of retrospective valuations put forward by expert witnesses for opposing parties in 40 UK professional negligence cases brought by mortgage lenders against valuers showed they differed on average by +22% to -22%. It noted that this strongly contrasted with the view routinely put forward by expert witnesses that the acceptable margin of error is rarely greater than 15%.

The Australian data extracted from eight reported cases on negligent valuations were supplemented by details of 19 valuations of the family home in 17 reported cases decided by the Australian Family Court. It found expert witnesses in the Australian negligence cases varied from each other by an average of 15.6% and that combined with the Family Court cases the average variation was still 15%. The paper also reported on a survey of expert witness members of the Australian Property Institute who were asked to specify the margin of error they would give if asked by a judge in court. 69% suggested it should be no more than +/- 10% in normal circumstances and no response exceeded 20%.

The above research refers to traditional valuation practice, not mass valuation. Most people agree that the margin of error in mass valuation is likely to be much higher than in traditional single property valuation. As Professor MacFarlane put it in his evidence:

A. It stands to reason in operating a mass system that it's not going to be as accurate as handcrafting individual properties. If handcrafting is the alternative when the component factor may not be producing the right sort of value, then even the process here is giving, I suppose, greater certainty to those that handcraft, those that are directly valued. So I think if you work backwards from that, then, yes, necessarily you should expect that the margin for just error that's not the sort of error that can be easily corrected should be greater than for direct valuations. That's almost, I think, an essential part of this. I don't think anybody thinks that you can do quite as good through a mass appraisal method as you can by a more direct approach, direct comparison.

A number of international standards and best practice guides also address the limitations of mass appraisal in terms of accuracy of valuation outcomes:

- *The object of mass appraisal is to produce equitable valuations at low costs. Improvements in equity generally require increased expenditures.* [International Association of Assessing Officers – *Standard on Mass Appraisal of Real Property*, February 2002]
- *Proof of appraisal level and uniformity is gauged by statistical indicators in the modelling process and by comparison with subsequent sales data. It is implicit in mass appraisal that even when property-specified and calibrated mass appraisal models are used, some individual value estimates will not meet the standards of reasonableness, consistency and accuracy. Valuers engaged in mass appraisal have a professional responsibility to ensure that on an overall basis, models produce value estimates that meet attainable standards... Should appraisals be undertaken in times of rapidly rising or falling markets, the period for selection of sales prices should be adjusted accordingly. The degree of acceptable variation should reflect the volume and comparability of market evidence.* [International Valuation Standards Committee, *Exposure Draft of Proposed International Valuation Application –Mass Appraisal of Real Property*, August 2002.]

- *The Standard on Ratio Studies (IAAO 1999) suggests that the level of appraisal in each stratum (group of like properties) should be within 5 percent of the overall appraisal ratio in the jurisdiction, and the overall appraisal level should be within 10 percent of the legal level. For residential properties, uniformity, as measured by the coefficient of dispersion, should be 15 percent or less in older, heterogeneous areas and 10 percent or less in areas of newer and fairly similar residences [Robert Gloudemans, Mass Appraisal of Real Property, International Association of Assessing Officers, Chicago 1999]*
- *Accuracy is measured against current market evidence to the date of valuation...Accuracy is easily understood as percentage error. For example, it might be said that a valuation is within 10% of the actual price where actual price is the evidenced price in the base period (sale or rental, analysed and adjusted). Where the valuation is less than the actual price, the percentage error is computed from the formula $100(\text{actual price} - \text{valuation})/\text{actual price}$. If the valuation is greater than the actual price the percentage error is computed as $(\text{valuation} - \text{actual price})/\text{actual price}$.*

While the ideal is to produce a percentage error of zero, a value within 15% is generally regarded as acceptable. [Australian Property Institute, Professional Practice 2004, Appendix 1 Valuation accuracy and uniformity, Guidance Note 5.1 Valuation for Rating and Taxing]

In light of the studies into valuation accuracy and valuation variation, international standards and best practice guides, it appears that the Australian standard of a margin of error of +/- 15% as evidenced by the above quote from the Australian Property Institute Property Guidance Note 5.1 on Valuation for Rating and Taxing is not only in line with international practice but is a more realistic expectation in the context of the component method of mass valuation.

4.6.7.2 Actual percentage error

The only insight we generally have into valuation accuracy is to compare valuations made under the mass valuation system against the evidence of land values derived from the analysis of actual sales of properties.

The *Rating & Taxing Valuation Contract Management Procedures Manual* requires contract managers to check (via the Variation by Sales Report) that land values fall within approximately 5% of the adjusted land values. This performance standard is inconsistent with the equivalent standard applied to the mean value price ratio (see 4.6.7.4 below) that calculates the mean relative accuracy of the level of values relative to sales. That standard effectively acknowledges a 15% margin of error as acceptable as long as issued values do not exceed the market level identified by the adjusted analysed land values taken from the sales. This inconsistency in standards within the *Procedure Manual for Contract Valuers* needs to be addressed.

As mentioned above, a percentage error up to 15% is also recognized as the acceptable standard in Guidance Note 5.1 of the Australian Property Institute and New Zealand Property Institute *Professional Practice 2004*.

For the purposes of the investigation, we examined the percentage of sales of residential properties used for statistical reporting purposes where the variation between the adjusted analysed land value derived from the sale and the assigned valuation exceeded both the 5% and the 15% margin of error standards in a sample of 43 districts from the 2004 valuation program.

Table 14. Variations between adjusted analysed land values and assigned valuation for residential sales – 2004 valuation program – sample of 43 districts

District	Contractor	Total Residential Sales in Statistical Reports	% of Sales with variations between 0-5%	% of Sales with variations between 5-15%	% of Sales with variations more than 15%
Ashfield	QV	33	39	24	36
Auburn	CVS	31	32	42	26
Bankstown	PVS	103	39	30	31
Bathurst	PVS	82	18	34	48
Baulkham Hills	CVS	65	35	58	6
Bega Valley	PVS	122	16	26	58

District	Contractor	Total Residential Sales in Statistical Reports	% of Sales with variations between 0-5%	% of Sales with variations between 5-15%	% of Sales with variations more than 15%
Blacktown	CVS	58	28	40	33
Blue Mtns	PVS	110	6	25	69
Burwood	QV	11	9	18	73
Byron	PVS	117	70	22	8
Camden	QV	205	50	42	8
Canada Bay	QV	21	5	19	76
Great Lakes	PVS	76	14	37	49
Greater Lithgow	PVS	15	33	40	27
Greater Taree	PVS	52	25	15	60
Griffith	PVS	26	35	42	23
Hastings	PVS	60	23	38	38
Hunters Hill	QV	41	15	37	49
Hurstville	SAVS	46	52	20	28
Kiama	PVS	169	12	41	47
Kogarah	SAVS	29	48	24	28
Ku-ring-gai	PVS	83	17	36	47
Lane Cove	PVS	37	11	43	46
Leichhardt	QV	23	13	30	57
Liverpool	QV	191	37	42	21
Marrickville	QV	54	24	28	48
Mosman	PVS	47	4	28	68
Muswellbrook	PVS	68	32	44	24
North Sydney	PVS	34	9	18	74
Parramatta	CVS	40	55	30	15
Pittwater	PVS	57	19	33	47
Rockdale	SAVS	35	57	23	20
Shellharbour	PVS	114	22	32	46
Shoalhaven	PVS	338	34	37	29
Singleton	PVS	29	28	52	21
Strathfield	QV	24	0	17	83
Sutherland	SAVS	84	40	43	17

District	Contractor	Total Residential Sales in Statistical Reports	% of Sales with variations between 0-5%	% of Sales with variations between 5-15%	% of Sales with variations more than 15%
Sydney City	QV	44	27	32	41
Wagga Wagga	PVS	35	49	31	20
Waverley	CVS	101	33	30	38
Wentworth	PVS	50	60	40	0
Wingecarribee	PVS	138	28	37	36
Woollahra	CVS	71	38	42	20
Total	43	3169	31%	35%	35%

The above table indicates that only 31% of sales on average met the strict 5% margin of error standard across the sample districts and only 66% of sales across these 43 districts were within the 15% acceptable margin of error. A significant number (35%) were outside this latter standard.

The distribution of the margin of error was not uniform. 21% of the sample districts had more than half their sales outside the acceptable 15% standard, and 44% had more than 40% of their sales outside that range. In six districts, more than two thirds of the sale properties had variations of more than 15%.

To gain a better appreciation of the number of districts with high range percentage errors, we also calculated the median percentage error and the percentage of districts with percentage errors above 25% and 40% respectively. The sales used were those provided with the statistical measures (i.e. not all the analysed sales, but the ones closest to the base date). The results are set out in the following table:

Table 15. Distribution of high percentage errors between adjusted analysed land values and assigned valuation for residential sales used in statistical reports – 2004 valuation program – sample of 43 districts

District	Median percentage error	% of sales with percentage error above 25%	% of sales with percentage error above 40%
Ashfield	-4.8%	15.2	9.1
Auburn	0.54%	22.6	3.2
Bankstown	6.85%	24.2	9.7
Bathurst	9.09%	22.2	8.6
Baulkham Hills	0.56%	1.5	0
Bega Valley	17.19%	33.6	13.1
Blacktown	8.08%	6.9	0
Blue Mountains	19.4%	33.6	14.5
Burwood	22.67%	36.4	9.1
Byron	0.02%	0	0
Camden	4.14%	6.8	5.9
Canada Bay	23.10%	28.6	4.8

District	Median percentage error	% of sales with percentage error above 25%	% of sales with percentage error above 40%
City of Sydney	14.09%	29.5	10.6
Great Lakes	13.76%	34.5	17.1
Griffith	9.64%	11.5	3.8
Hastings	9.55%	28.8	18.6
Hunters Hill	14.58%	14.6	0
Hurstville	3.59%	8.7	2.2
Kiama	13.79%	20.2	5.4
Kogarah	5.5%	10.3	3.5
Ku-ring-gai	14.29%	20.5	6
Lane Cove	14.19%	27.03	2.7
Leichhardt	15.42%	30.4	0
Lithgow	6.46%	6.7	0
Liverpool	4.55%	3.1	0
Marrickville	11.55%	27.8	9.3
Mosman	26.98%	53.2	21.3
Muswellbrook	5.77%	14.7	7.4
North Sydney	22.69%	44.1	23.5
Parramatta	-0.31%	2.5	0
Pittwater	13.82%	29.8	12.2
Rockdale	4.45%	14.3	0
Shellharbour	-13.76%	22.1	10.6
Shoalhaven	7.2%	9.5	1.2
Singleton	6.43%	10.3	3.4
Strathfield	23.7%	41.7	0
Sutherland	6.67%	8.1	0
Taree	17.9%	31.3	11.8
Wagga Wagga	1.77%	8.6	2.9
Waverley	11.06%	14.6	1
Wentworth	1.33%	0	0
Wingecarribee	8.54%	20.3	4.3
Woollahra	9.09%	5.5	1.4

As the above table shows, almost one in six districts has more than a third of their sales with percentage errors above 25% and almost a quarter of districts had more than 10% of their sales with variations of more than 40% between the adjusted analysed land value and the issued valuation.

The percentage error variations in the vast majority of cases indicated the issued values were conservative in relation to sales information meaning that overwhelmingly in 2004 there was undervaluing across the districts of New South Wales rather than overvaluation.

Extrapolated to the whole population in each district, these figures are extremely worrying as indicators of the standard of valuation accuracy currently being achieved under the component method of mass valuation.

4.6.7.3 Coefficient of dispersion

The simple percentage error statistic is a useful insight into valuation accuracy at the single property level. However, in mass valuation systems there is usually a need to combine the values of accuracy of individual valuations in aggregate samples to provide combined measures of accuracy and uniformity. Accuracy normally refers to the closeness of valuations to actual prices whereas uniformity is a measure of the consistency of the percentage errors across a sample.

The Valuer General has adopted three particular measures to provide quality assurance feedback on the accuracy and uniformity of valuations –the coefficient of dispersion, the mean value price ratio and the price related differential.

While some consider the coefficient of dispersion as a measure of uniformity and accuracy, it is principally a measure of consistency in valuations. Ideally, properties of similar real value should have similar assigned valuations at each base date. This is important in the rating and taxing context because citizens expect that the burden of rates and taxes should be born equitably.

The coefficient of dispersion (COD) is a statistic widely used in mass appraisal systems worldwide to measure uniformity. It is based on the differences between individual ratios of valuations to actual prices and the median of all ratios in the aggregate sample. It expresses the average fluctuation of the sales ratio as a percentage of the median sales ratio thus providing a measure of valuation uniformity that is independent of the level of values. This permits direct comparison between property groups.

The Procedure Manual for Contract Valuers states:

The COD is a measure of the accuracy of the grading within a component or group of properties. Therefore if value levels are inconsistent the variation between those values and the sales evidence used will be considerable. This will show up in the COD not meeting the standard required.

Low CODs tend to be associated with good valuation uniformity. The acceptable standard for the COD specified in the *Procedure Manual for Contract Valuers* is that it be less than 15. This is an arbitrary standard and different jurisdictions use slightly different standards⁵⁰, however, it is generally accepted that CODs above 15 are “starting to indicate reasonably substantial differences in the value ratios and inconsistency in the comparison of valuations to adjusted (land) prices”⁵¹.

According to the procedures manual, a result greater than 15 indicates that there is too much variation within the group. This may indicate that the grading of the land values is incorrect and that there are large discrepancies between the values attached to some parcels compared to others. Such results indicate the need to review the value levels.

The procedures manual requires the COD to be calculated separately where applicable for residential, commercial, industrial and rural zones for each district.

The manual states:

Where there are sufficient sales (at least 50), the statistical tests should use sales falling within 2 months on either side of the base date. If a range wider than this is used the Contractor must identify the range adopted.

The contractor must supply details of all calculations in a format that is both transparent and informative. The Contract Manager should be able to review the calculations supplied to identify trends or possible areas of concern.

In a great many of the districts, the available sales for commercial, industrial and rural zones do not meet the minimum sample size number and therefore the statistics produced may not be as reliable.

We examined the statistical reports for 90 valuation districts to ascertain how many met the standard for the COD. The results are set out in the following table:

Table 16. Uniformity of land values relative to sales prices –compliance with COD standard –sample of 90 districts 2004 valuation program

Zone	Total Districts with zone	No. of districts where COD was supplied	No. of districts where COD supplied and was not in range 0-15	% of districts not in acceptable COD range	% of districts in acceptable COD range
A Residential	72	68	13	19	81
B Business	62	45	16	36	64
I Industrial	66	34	12	35	65
R Non-urban	64	58	18	31	69

For the residential zones, 19% of the districts in the sample reported CODs outside the acceptable standard.

Of the 13 districts that did not meet the standard of 0-15, ten were within 15-20 and Scone, Mosman and Yass Valley were between 20 –30.

Of the 16 districts that did not meet the standard for their commercial zones, six were within 15-20, six were between 20 and 30, and Pittwater, Manly and Mosman were above 30 and Hastings was above 40.

Of the 12 districts with industrial zones not meeting the standard, five were between 15 and 20, four between 20 and 30 with Hastings being above 30, Yass Valley being above 40 and Tweed above 50.

Of the 18 districts where their rural zones did not meet the standard, eleven were between 15-20, six were over 20 but under 30 and Oberon was above 50.

According to a training material prepared by Professor MacFarlane⁵², problems with the COD may not be easy to resolve, as it requires changes to be made to individual property values or groups of property values. Accordingly, it is necessary to re-examine the sales and valuation data. Non-conformance may be related to imprecision in the adjusted sale values rather than the assigned values *per se*. However, if the adjusted analysed land values are satisfactory, the valuations require adjustment. Where neither can be adjusted so that the COD comes within the standard, then this may indicate a need for handcrafting and/or problems with the structure of the components comprising the zone.

In his evidence to the inquiry, MacFarlane commented upon the above outcome for residential zones:

What happens with the ones that don't actually conform? I would hope for most of these if they haven't conformed then that's not to rule them out altogether because again I don't think these statistical measures are an end in themselves. They're really just demonstrating something about, you know, the analysis that's going on. So I would at least have hoped here not that something should be abandoned here because you've got things that are outside the range, but rather, "Well, we'll go and scrutinise this to some extent. We'll have a look at what's actually going on here and you may make some adjustments as a result or you may not."

...So I would say with all of these just because some are outside the range isn't necessarily a demonstration of failure or something of that sort. You know, again some of these are a bit arbitrary: you say it's 0 to 15. You know, if we said it's 0 to 10 you'd have a lot more; if it's 0 to 20 you'd have a lot less. Where should the figure be? I would have thought that hopefully these arise because over time we've decided that, you know, the 0 to 15 tends to give us reasonable results and it's to scrutinise the things that don't fall in here, not to reject them, so is it a worry? I would have thought for the residential area, yes, something around 20 per cent is probably not unduly a worry. If some of these were out as far as 60, you know, it's the scope of it and the scale of it, I suppose, that's partly at issue. If you had some of these where when you've done the analysis it was 60 and not 15 then I would be quite worried, but if all ... were between 15 and say 20 and a few just 20 to 25, maybe that's not such an issue.

As the COD is more a measure of uniformity than accuracy, the above results and expert opinion appear to suggest that there is not a significant problem with uniformity or consistency of values in the 2004 valuation program in terms of residential zones. However, a low COD can be achieved simply from consistent but inaccurate values.

The sample sizes for the CODs produced for the other zones were generally small so the reliability of those statistics is more questionable and it is difficult to make any general observations.

4.6.7.4 Mean Value Price Ratio

This quality assurance measure is the main measure used to judge valuation accuracy. It shows the mean (or average) level of accuracy of the assigned values compared to the sales evidence. It gives an overall figure showing how close the assigned land values are to the adjusted analysed land values derived from analysis of sales. It is calculated by dividing in each instance where there is a sale of land, the assigned land value by the adjusted analysed land value at the base date, aggregating the results and dividing the total by the number of sales, then expressing this as a percentage.

Originally, the standard set in the 2003 edition of the procedure manual was 85%-110% but the Valuer General deemed it unacceptable to have values above the market level and from 2004 the standard has been set at 85-100%. That is, a margin of error of 15% is acceptable as long as assigned land values are not above the actual land value evidenced by the sale. The MVP is required to be calculated only for residential zones.

Again we examined the statistical reports for 90 valuation districts to ascertain how many met the standard for the MVP. Sixty-eight of those districts had residential zones for which they calculated an MVP. The results are set out in the table below:

Table 17. Accuracy of land values relative to sales prices –compliance with MVP standard –sample of 68 districts with residential zone – 2004 valuation program

Total Districts where MVP supplied	Range	No of Districts with residential zone results in range	% of Districts with residential results in range
68	85-100%	45	66
	Less than 85%	17	25
	More than 100%	6	9

Only 66% of districts with residential zones met the MVP standard. 25% had an MVP below the standard that indicates the average imputed valuation was less than that which sales figures would suggest, that is, a degree of undervaluing has taken place. Six districts had MVPs above 100%, which indicates a degree of over-valuing may have occurred.

Of the 23 districts with MVPs for their residential zone below the standard, 13 were only slightly below from 80-85% whereas Strathfield, Mosman, North Sydney and Great Lakes had MVPs between 70-80%. For the residential zones in these districts, the imputed values were well below what might be considered the market rate. Four districts (Temora, Muswellbrook, Byron and Baulkham Hills) had an MVP over 100% but below 105% and Gloucester had the highest MVP of 109.79%.

Low MVPs usually indicate that certain areas or classes of property need regrading or that the component factors need to be higher. Changing the component factor in these circumstances brings valuations more into line with the sales evidence, assuming the adjusted analysed land values used in the calculations are accurate.

Again the non-conforming measure is a flag that indicates the need for further investigation as Professor MacFarlane stated in his evidence when asked to comment upon the high number of districts that had MVPs outside the standard:

A. Well, I think the comment before would sort of apply equally here. It would be interesting to know how far outside those areas these ones actually fell. If they're a long way away from the 85 or 100 I would be a bit concerned. Even when they fall within here, you know, if something has only just reached 85, you know, it still may need to be looked at.

Given nearly a third of the 45 districts with a conforming MVP for their residential zone had "only just reached 85" to use Professor MacFarlane's words⁵³, these results suggest nearly half the districts in the state with residential zones had low or non-conforming MVPs that warranted investigation.

4.6.7.5 Price Related Differential

The PRD is also a statistic widely used around the world in mass valuation systems as a quality assurance measure. It relates to equality in the valuation of low and high value properties. It aims to measure whether the valuation ratios are consistent between lower valued and higher valued properties. Valuations are considered regressive if high valued properties are under-valued relative to low value properties and progressive if high valued properties are relatively overvalued.

The PRD is calculated by dividing the average land value to sales ratio by the weighted average, which is the sum of the assigned land values divided by the sum of the adjusted analysed land values. The use of the weighted average means the PRD in practice has an implicit weighting or bias towards higher valued properties so accordingly the standard is not symmetric and is set at .98 to 1.03. A PRD less than .98 indicates that valuations are progressive, that is, the high valued properties may be overvalued in relation to low valued properties. A PRD above 1.03 conversely indicates that the valuations may be regressive, that is, the high valued properties are undervalued relative to the others.

While the PRD is useful for identifying valuation bias at either end of the value spectrum, it is a measure not without limitations. It is susceptible to sampling size errors and can be heavily influenced by extreme ratios, particularly of high valued properties. If anomalous ratios are found among both high and low valued properties, they can compensate each other in the calculations thus resulting in a PRD within the standard that masks such problems. Consequently, the PRD provides only an indication, not proof, of price related bias.

The *Procedure Manual for Contract Valuers* states:

Where the PRD exceeds acceptable limits values should be analysed to identify and address the cause. Possible causes may be the inclusion of outliers, individual properties with unusual characteristics, inappropriate component composition or grading errors.

In our review of statistical reports from 90 valuation districts, we found 70 districts where a PRD had been produced for their residential zone. The results are set out in the following table:

Table 18. Vertical equity of valuations – compliance with PRD standard – sample of 70 districts with residential zone – 2004 valuation program

Total Districts where Residential PRD supplied	Range	No. of Districts with residential zone results in range	% of Districts with residential zone results in range
70	0.98-1.03	53	75.71
	Less than 0.98	1	1.43
	More than 1.03	16	22.86
	ALL	70	100.00

Approximately 24% of districts had a PRD outside the acceptable standard. Only one district (Yass Valley .94) had a progressive PRD less than the standard. That is an indication that its high valued properties were overvalued relatively to the low valued properties. The majority of non-conforming PRDs were regressive indicating that the high valued properties were undervalued relative to others. Of the 16 districts with regressive PRDs, seven were between 1.03 and 1.10, eight between 1.10 –1.20 (Bega Valley, Great Lakes, Hasting, Hornsby, Kiama, Pittwater, Willoughby and Warringah) and Manly was 1.25.

4.6.7.6 Non-compliance with more than one statistical measure

The statistical measures are primarily diagnostic tools or flags to alert valuers to potential problems with the assigned values. More districts had non-conforming MVPs than COD or PRDs. Because it is extremely sensitive to changes made consistently to property values such as by changing the component factor, problems indicated by non-compliance with the MVP standard are potentially easier to rectify than problems indicated by either the COD or PRD. Non-compliance with more than one measure can be an indicator of more fundamental problems that may be more difficult to readily rectify.

Of the sample of 90 valuation districts that we examined the statistical reports for six districts (Bega Valley, Great Lakes, Hastings Manly, Mosman, and Pittwater) failed to comply with the standards for each of the three primary statistical tests (the COD, MVP and PRD). Seven districts (Bathurst City, Burwood, Greater Taree, Muswellbrook, North Sydney and Yass Valley) failed to comply on two of the measures and 16 failed to comply on one. Of the latter, five had non-conforming PRDs and 11 had non-conforming MVPs.

4.6.7.7 Limitations of the key statistical measures

The introduction of quantitative quality assurance measures is obviously an important reform in assisting the Valuer General to fulfil his statutory functions of ensuring the integrity of valuations and monitoring the standard of valuation services provided under valuation contracts. The use of the COD, MVP and PRD statistical measures is consistent with their use as quality assurance measures in many other systems around the world where various types of mass valuation methodologies are used. The measures are one means by which you are able to get an insight into the level of accuracy and consistency of the valuations made under the component method.

However, they are not infallible measures and rightly need to be used as flags or indicators of problems that need to be further investigated to determine whether there is in fact serious inaccuracy or lack of uniformity in the valuations made. All three measures use a sampling methodology whereby assigned values are compared to some evidence of 'real values'. In each case this involves comparing the assigned values applied to a selection of properties that have been sold on the open market to the actual sale price of those properties, or more precisely, the land value portion of the sale price that is adjusted to the base date.

While this market evidence is the strength of the measures, the measures are based on a number of assumptions. These include the assumption that the sales themselves are open market transactions, whereby the price paid is a true reflection of the value and is a product of general market forces rather than the preconceived view or vested interest of a particular buyer. It is also assumed the sales are generally representative of the properties within the larger group of properties that are being valued. Another critical assumption is that the adjusted analysed land values derived from the sales data and used in the calculations of the statistical measures are themselves accurate. Any transgression of these assumptions can affect the accuracy and usefulness of the statistical measures as diagnostic tools. These limitations are discussed in more detail below.

The accuracy of statistics as estimators of what is happening in the whole population (in this case, all the properties in particular zones in a district) depends upon the representativeness of the sample used to calculate those statistics. Ideally the sample should be a miniature replica of the population. In property valuation, this means that the types of property used to calculate the statistics should appear with approximately the same relative frequency in both the sample and the population. Representativeness therefore is primarily a function of the sample size and the method of selection. Ideally selection should be random so that each property in the population has an equal chance of being included in the sample.

Unfortunately sales do not meet the strict definition of random samples as some types of property tend to sell more frequently than others or are otherwise un-representative. For example, the Contract Manager for the City of Sydney gave evidence that sales in many of the components of that district favoured development sites that were not indicative of value movements among the "little terraces" that constituted the majority of the properties in those components.

The larger the sample size the more likely the characteristics of the sample converge with those of the population so that the statistics generated from the sample are more likely to be valid. In fact, a rule of thumb is that to halve the statistical margin of error, you generally need to increase your sample size fourfold. In this respect, there is also limited control over sample size because valuers can only use the sales that are transacted and reported and they only analyse a sample of those. In the non-residential zones, this often means few sales are available which seriously restricts the reliability of any statistics generated on those. For example, in calculating the COD, MVP and PRD, only two of the districts had more than 20 sales of commercial and industrial properties. Most had less than ten. This means any statistics produced for those zones are unlikely to be reliable indicators. Likewise, only eight districts had more than fifty sales of non-urban properties (the suggested minimum number in the Procedure Manual for Contract Valuers). Even half of the districts with residential zones calculated their statistics on a lesser number of available sales than the suggested minimum number.

The practice is to exclude from the statistical calculations of the COD, MVP and PRD any sales that are suspected of being unrepresentative of the true market and not at arm's length. For example, a land owner may pay a premium to acquire an adjoining block or an exchange of properties between relatives or within a company may be heavily discounted and not be representative of their true market value. While most of the sales schedules that accompanied the statistical reports for the 2004 valuation program identified such outliers that were excluded from the calculations, this was not always the case. For example, the sales of benchmark properties outlined in Table 10 were considered by the valuer to be anomalous yet not all were excluded in the calculation of the COD, MVP and PRD for Kiama in 2004.

The analysed land value for many sales included in the statistical calculations is derived from the analysis of improved sales. The lack of application of a uniform methodology for valuing improvements introduces an element of possible error into those calculations, which are in turn relied upon in the calculations of the statistical measures. Likewise, the analysed land values have to be adjusted accurately to the base date. As the discussion in sections 4.5.2.5 to 4.5.2.7 above indicates, there appears to have been serious problems in the adjustments made or not made to analysed land values in the 2004 valuation program, which also introduces another element of potential error into the statistical calculations. Professor MacFarlane confirmed the potential for the statistical measures to be contaminated by inaccurate adjustments in his evidence to the inquiry:

Q. The MVP statistic measures the accuracy of values relative to sales price. However, it uses the adjusted analysed land value as an input into its calculation. Would it be fair to say that a non-conforming MVP could be as much a statement about the inaccuracy of the adjustment made to the analysed land value as to the accuracy of the assigned value of the properties?

A. Well, I think the short answer is yes. I mean I think the MVP statistic assumes that an adjustment has been made reasonably accurately to the base date. If that's not occurred then certainly those differences are going to contaminate the measure. If you're looking at it just to be a measure of accuracy you're sort of confounding two different sources of variation in the one measure: so I think the answer is yes.

Our examination of the statistical results revealed another significant source of error that limits the reliability of the statistical measures produced for the 2003 and 2004 valuation program. This relates to using sales where the assigned value was handcrafted.

The fundamental purpose of the COD, MVP and PRD statistics is to provide an insight into the level of accuracy and uniformity of the valuations produced through application of the component factors to the majority of properties. This can only be tested if the assigned values of the sales properties used in the statistical calculations are values derived from application of the component factor, or in some cases, a sub-component factor. That is, the values have to be values produced by mass valuation, not individual valuation. As a standard practice therefore, handcrafted properties, or more precisely, properties where the assigned value was not produced by application of a component or sub-component factor⁵⁴, should be excluded from the calculations of the COD, MVP and PRD.

At the moment, this is not required. It is difficult to assess how many handcrafted valuations have been used in the calculations of the statistical measures in 2003 and 2004 as the fact of handcrafting is not flagged in the sales lists that underlie the statistical calculations (nor are handcrafted values flagged on the Valnet system). We certainly were able to identify some cases of sales with handcrafted values that were included in the 2004 statistical calculations and accordingly contaminated those particular statistical results. The *Procedure Manual for Contract Valuers* should be amended to provide further guidance on this point.

Taking all of these considerations into account, some caution needs to be applied to interpreting the level of non-conformance with the statistical standards as solid proof of critical defects in the component method of mass valuation. Non-conforming measures, however, are the best evidence available of potential problems with accuracy and consistency of valuations so therefore they have to be investigated.

4.6.7.8 Monitoring of statistical outcomes

The introduction and use of the statistical measures and standards specified in the *Procedure Manual for Contract Valuers* has not been without some controversy. While it was excised from the first version of the *Rating and Taxing Valuation Contract Management Procedures Manual*, the following excerpt from its predecessor, the draft *Mass Valuation Procedure Manual for Contract Managers* July 2003, captures the initial approach to the status of the statistical checks which also appears to be indicative of the current attitude adopted by most contract managers:

The initial stages of the use of this data may show some unusual or unintended results. It is not intended that the use of these checks overrides or replaces sound valuation practice or judgement. These checks are intended to provide a more reliable guide to the consistency of valuations and the valuation result. Contractors will continue to be required to make valuations based on sales evidence not statistical results. Where the results deviate from the recommended standards the contract manager can accept the values with an explanation for the variation.

The *Rating & Taxing Valuation Contract Management Procedures Manual* that has applied from the 2004 valuation program simply says "Statistical measures are to be provided in accordance with the *Procedure Manual for Contract Valuers*". In turn, the *Procedure Manual for Contract Valuers* requires the production of the statistical measures prior to delivery of the proposed values, and states:

*The Valuer General has supplied the parameters or standards that these results **must** achieve.* (emphasis added)

In practice, however, it appears that the importance of values complying with the statistical standards may have been played down even well into the 2004 program. For example, the minutes of the contractors meeting for the St George/Sutherland contract in May 2004 on the subject of statistical checks records the advice:

Compliance with statistical checks is desirable but not mandatory –provide an explanation why there is non-compliance

By specifying a requirement for compliance with set statistical standards in the procedures manual, it appears many assumed that in practice contract valuers would run the statistical tests over their initial proposed values and use them as quality assurance measures during the verification process to investigate anomalies and fine tune the values before submitting their proposed values to the contract managers. If there was still non-conformance at the time proposed values were submitted, a detailed explanation was expected to be provided. From our interviews with a sample of contract valuers and contract managers, this in fact does not appear to be a typical practice.

Our interviews with contract valuers and contract managers strongly indicated that little attention has been paid to the statistical outcomes to date. It appears that the statistical requirements were put in place without any thought given to how they should be monitored. Basically it has been left to contract managers to review them on an individual district basis.

Where the statistical measures have not been in compliance with the standards set down in the *Procedure Manual for Contract Valuers*, most contract managers noted that and asked the contract valuer for an explanation which may or may not have been provided before the values were accepted into the Valnet system.

In the audit of a sample of district files we completed as part of the investigation, only two of the ten files where the district had non-conforming statistical results contained a written record of an explanation from the contractor.

On 29 November 2004, the Manager Valuation Quality in the Office of the Valuer General emailed all Regional Valuers requesting them to confirm that the statistical checks produced by the contractors complied with the requirements as outlined in the procedures manual. If they were outside the parameters, he asked them "1. Why have they been accepted? 2. What action has been taken to rectify the situation to ensure statistical checks comply with the Procedures Manual"?

The responses he obtained were hardly comprehensive:

- *"as discussed today there are insufficient numbers of industrial sales in Tweed to yield meaningful statistics".*
- *"due to variations experienced in certain areas such as water views and non views, prime streets directly adjacent to more average areas there has been a disparity present in some of the statistical data. The complex areas of zone and development has also been a factor. In order to rectify this situation we have undertaken extensive regrading throughout the medium density areas of North Sydney and have also completed selected hand crafting in other areas".*
- *"Lane Cove is outside the criteria however handcrafting of waterfront entries has been undertaken during the program".*
- *"The following actions are proposed: meetings with contractors are scheduled before December 22 to determine: assessment of program and areas of improvement, extent of action required by statistics, timetable for completion of analysis of statistical data, timetable for completion of rectification measures, priority to be given to areas where section 14A action may be required".*
- *"In the Procedures Manual it states more than 50 sales are required to accurately depict an accurate representation. As per the majority of contract areas residential is the only district that would fit this requirement".*
- *"Basically they are saying more than 50 residential sales are required to get an accurate result from the stats. Given the majority of the City of Sydney won't have that many sales its difficult to comply with the statistics calculation".*
- *"The contract manager would take into account: the limited number of sales used-typically small LGA's in the Western Region; the issue of districts that have been affected by Council amalgamations – part districts valued; overall need to review & update components. Ultimately approval of factors & values would be done, taking into account the sales supplied, benchmarks valued & hand crafting done where applicable! The contractor advised that a review of the components in the LGA to be done as a priority in the new year".*
- *"The final reports for the Burwood contract districts were not supplied until late October leaving very little time for checking of the valuation recommendations, the priority was the completion of the base date 2004 programme".*
- *"It is widely accepted both in the market place and amongst other rating contractors that I have discussed value levels with that the market over the preceding 12 months to BD 1/7/2004 particularly for residential property has not experienced a uniform upward movement. This increase has not been a steady upward trend, but rather a continuation of strong growth after 1/7/2003 followed by a period of stagnation and then in some cases by a drop in values to 1/7/2004".*

- *"The sample of analysed sales used in the statistical reporting reflects this trend in the market place. Vacant land sales analysed in the first part of the reporting year indicated much higher increases to existing values than those looked at closer to 7/2/2004 BD. As the amount of sales in the sample of analysed sales used in any reporting year tends to be greater in the first part of the reporting year than the later part, then obviously this trend is accentuated in the statistical parameters."*
- *"In such a market where the majority of the most reliable evidence is within a month or two on either side of the BD, these sales are often the most difficult to identify, investigate and therefore used in the statistical reporting process. Secondly there are usually not enough of these sales (the procedure Manual states at least 50 of these sales within 2 months on either side of the BD) either transacted or reported on to adequately perform the statistical measures required. It becomes increasingly difficult in performing such measures in a slowing market where the volume of adequate sales are not available for analysis and particularly so in the Burwood Contract area where the individual reporting districts are so small and the number of sales are generally fewer than in larger districts."*
- *"In response to this uncertainty a conscious decision was made in light of the obvious downward trend in the residential market to recommend component factors that would comfortably reflect the state of the market."*
- *"Using this measure resulted in only one of the districts, i.e. Ashfield complying with all 3 of the statistical indices. Of the other districts, Burwood & Marrickville had 2 of their individual indices outside of contract standards, however both these were within several points of these standards are therefore not considered of great concern overall. As for the other 4 districts, each of these had one index outside standards but again the results for these districts were considered acceptable in the overall context of what we were attempting to achieve"*

While the problem of small sample sizes is acknowledged, none of the other explanations provide an adequate explanation for why particular measures were outside the acceptable parameters. Even the most detailed explanation raises questions given that a reliance upon earlier sales should have no detrimental affect on statistical results if the sales data is properly adjusted for time.

None of the contract managers appear to independently investigate reasons for non-conforming statistics. Clearly the statistics are accepted on face value. As evidence of this, one contract manager had been provided by his contract valuer with a duplicate copy of the statistics for another district and had failed to notice that until we questioned him about the matter.

Neither do contract managers appear to scrutinize the sales list used to calculate the statistical measures. Selective use of sales can produce misleading statistics. In our review of the statistics we had cause to question some contract valuers about why they had included some relatively old sales but had excluded others (which potentially would have lead to non-conforming results). While at least one valuer confirmed that two sales were excluded by oversight, we were satisfied that the selections of sales for the purposes of compiling the required statistical measures was generally done in accordance with directions in the *Procedure Manual for Contract Valuers*.

As part of the investigation we also independently ran verification checks upon the calculations of a random sample of ten statistical reports. All were accurate.

Generally, there appeared to be a low level of understanding about the meaning and potential impact of non-conforming statistical results among both contract valuers and contract managers. None of the contract valuers or contract managers had received any training in the application and interpretation of the statistical measures prior to the 2003 or 2004 valuation program where they were utilised⁵⁵.

The principal cause for concern is that the presentation of non-conforming statistical results occurs at a time when little or nothing can be done to investigate their implication before the proposed values are adopted. This is mostly a consequence of timing but during the 2003 and 2004 valuation programs this was also caused by a lack of understanding among some contract managers of the significance and implications of the statistical results. In our interviews with contract managers we found a wide range of understanding of and attitude towards the place of the statistical checks as quality assurance measures as the following transcript quotes indicate:

- *Then we come to the statistics and the statistics start showing you a different story and you think "Well, wait on a sec, I was generally satisfied with the process. I can't go back and individually value each of those properties in the component. There is a point in there where I have got to accept that the process has taken place, that it is fair and accurate.*
I guess I have overridden them, overridden the statistics and sort of said, "Look, I have gone through the process with them, I've looked at this sale, I know that they had problems here. I know that this didn't fit in. I am happy to let the sales override the statistics on this occasion." It doesn't mean it will happen every time.
[Mark Glanville, District Valuer, contract manager Lane Cove district]

- ...these things [statistical reports] should not be hitting our desk and our table without explanation. So it's not – we don't have the resources inhere to identify, to pull apart all these components on the 29th and 30th of October, and determine where there may be an issue here, if there in fact is an issue. Now, with some of them there's going to be no issue. In some of them there possibly are issues. But, at the end of the day, the ability to do that at the 29th and 30th of October is nonexistent [Geoffrey Thompson, District Valuer, Newcastle, contract manager for Hasting/Greater Taree district]
 - but why don't they [contract valuers] tell me that this statistic tells me that all the values are homogeneous or whatever the COD is?
- Q. Why didn't you ask them?
- A. Why didn't I ask them? Because I don't like statistics.
- Q. That's not an excuse.
- A. My excuse – I don't like statistics. I don't fully understand this and my criticism of the department in relation to the statistics is that they have not given, to my understanding, any of the contract valuers, the contract managers, educational training in it. Now if they did that, I might understand it and I might think that's a good tool. At the present time I don't see it as a good tool. I see it as a tool for the contractor to tell me what he's done and why they fit and why they don't fit. [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]
- [Timing of the provision of the statistics] It would be better to get them earlier, yes. By the time you get them it is pretty much done and dusted. Again, it is their role to ensure that they meet those statistics. It is in their procedure manual. They are the ones that have to –
- Q. So, any fine-tuning, adjusting of values in order to bring them into line with the standard should have already been done, so by the time they get to you, everything should meet the standard, shouldn't it?
- A. That's right. Yes, and they sign off on it and say that, you know, they have met the standards and everything is okay. You see, I think the reason why they are hesitant to supply them earlier is because they are still in the process of handcrafting and so forth, so I guess they don't want to supply you with something that's meaningless or whatever. The handcrafting goes right down to the end, basically, so they are trying to get as much time as they can to review and update values
- ...for most people, [it was] the first year they have ever used them, and half the time, they have probably got to the end and that's the last thing they have done, and they haven't met the standard. To go back and re-address all the valuation issues to get it to meet the standard would be a very difficult proposition. [Michael Parker, District Valuer, Sydney East, contract manager Woollahra/Waverley districts]
- ...statistics are still statistics, and you have to be careful that you are not applying them to the point where you are overriding valuation rationale... they need to be viewed as a tool... they don't replace valuation. They are just a guide as to what's happened in the end result. I think they have merit. [Michael Parker, District Valuer, Sydney East, contract manager Woollahra/Waverley districts]
 - Q. But your own evidence is you don't really understand what they [the results of the COD, MVP and PRD statistical measures] mean.
- A. No, I don't. I have no hesitation in saying that at all – no, I don't.
- Q. So how can you really say that it is reasonable or not?
- A. Because the manual tells me that they have got to fit within this and within that. So they did fit within it in some places and they didn't fit within it in other places and I asked them questions about why they didn't fit in other places. That was the answer I got. My time ran out. That was it. I can't give you any other explanation. That's the truth. [Ray Jones, District Valuer, Wollongong, contract manager Kiama district]
- The statistics reports are generated at the death. The question gets asked "Well, what does one do with them?"
- Q. And the reality it is too late to do anything?
- A. The reality is it is too late to do anything, but if I had – if I had concerns about them, then I would attempt to do something about them to a greater extent than I did with either of these because I – we have – as I said before, the valuers up there know their areas. I'm sort of telling very experienced people that they don't know what they are doing, to a degree, which [I have] a right to do, to a point. But the bottom line is I have the utmost confidence in their abilities up there. If it was a contractor that I didn't have confidence in what they were doing and then they just started the contract and they didn't know the area and all of those sorts of things, then, you know, concerns would be raised. But some things were allowed to be let go because of the confidence I have in the people up there and the amount of experience they have [Geoffrey Thompson, District Valuer, Newcastle, contract manager Taree/Hastings districts]

The failure to obtain detailed explanations for non-conforming statistical results means it is difficult to have confidence in the integrity of the values produced. A serious question is left hanging: 'Is there some fundamental problem in the values that requires the valuations to be re-done'. This was recognised by the Chief Valuer when he was questioned about the above statistical results:

The statistics are a guide, yes, and certainly it would at face value be preferable that they comply. Where they don't, there may be valid reasons why that's the case – there may not – but I think the valuation process is more often at this point still regulated through, you know, a consideration, if you like, or a use of the valuer's skill as a valuer to consider whether the valuations are representing what the market's showing. In the end, that's really the fundamental requirement, given that valuations, you know, on the objection process, for example, need to be able to be individually supported. So whilst I have to say I'm not particularly happy about what you're telling me, I think there are still significant checks and balances in the system and the contract managers analysing and watching what the contractors are doing is still a significant tool in ensuring that the valuations are of a reasonable quality. I guess the greatest concern, though, in the statistical checks not fitting the measures and not being fully rationalised, from sitting where I am it makes it difficult for me to be entirely confident that the consistency thing is right. ... It would be preferable that they were fully complied with, but not fitting those doesn't necessarily mean there's a problem, but it means that, from the point of view of demonstrating that there's not a problem, you know, it's much more difficult, because it comes down to relying on being able to rationalise things in a traditional valuation sense. [Chief Valuer]

Much more discipline needs to be exercised by contract managers to find out why values are not meeting the standards expected by the Valuer General and what needs to be done to correct the situation.

4.6.8 Revisiting the base line

One of the drivers for valuers applying conservative component factors appears to be the need to compensate for discrepancies caused by poor grading within some components. Apart from the minority of properties whose values are handcrafted each year, or re-ascertained as a result of objections or some more extensive re-grading exercise following the identification of some localised problem, the majority of properties have seldom if ever had their values reviewed in the context of the wider component and district since the inception of component mass valuation in 1989. As the *Procedure Manual for Contract Valuers* acknowledges:

The use of mass valuation techniques does have limitations, particularly over a period of time. The continued application of factors may lead to a distortion in the relativity of values within a geographical area.

The percentage of handcrafting varies from component to component and district to district. In any component we now have a mix of properties some of whose values may have been produced by the application of component factors on component factors each year since 1989, while others may have been handcrafted one or more times during that period. Many see the anomalies and error margins now evident in the system as a product of this cumulative indexing:

We're running a system whereby componentisation has been in the department now I think for almost 20 years, 80s

Q. '92?

A. Yes. '92. And like at no time has massive handcrafting exercises been undertaken in the CBD. But the further we get away from that point, the more and more factorised; some areas do come out of line.

....There has to be inset somewhere a timeframe or when value levels change by a percentage or something. Yes, I would argue very strongly that at some stage to correct these anomalies that are coming, and you can see lots of them, the only way to correct it is to go through and handcraft. [William Webster, District Valuer, City of Sydney]

The International Association of Assessment Officers recommends that properties be physically reviewed and re-valued at least every six years⁵⁶. This is because the quality of the available data on each property will have a greater effect than anything else on valuation accuracy. If the base data is wrong, the final estimate of value may be wrong. While there is a cost to such an undertaking, it is amortized over the intervening periods.

One contract manager gave evidence that periodic handcrafting of districts was originally seen to be a core requirement of the component methodology:

When it was described to us everyone thought, "This is ridiculous." The sell for it, if you like, was, "But, we understand that there's a necessity within, say, a three-year period, to fully go back and do your full inspections of everything to get the grading right again." So, from whenever that was, 15 years ago, or something, until today, that exercise has never been undertaken. So we've gone through a period of mass valuation upon mass valuation upon mass valuation that has eroded what was probably a really good valuation base when the resourcing was allocated to this in a different way. [Geoffrey Thompson, District Valuer, Newcastle]

Every contract valuer and contract manager examined as part of the inquiry acknowledged that the accuracy and uniformity of the values produced under the mass valuation system would be substantially improved if all properties in a district were periodically handcrafted. They only differed on the frequency with which this should happen. Most suggested it needed to be done every 3-5 years, perhaps longer in country districts where there was less volatility in value movements and greater homogeneity of components.

In 2004 the Valuer General initiated a pilot project to explore the benefit of periodic handcrafting of all properties within a district. The valuation contract for the Wollondilly and Wingecarribee areas contained a special clause that required the contractor to establish a structured program to handcraft valuations for all properties during the life of the three-year contract, to be staggered across the life of the contract on a component-by-component basis. Basically, the contract provided for a third of the area to be handcrafted each year and that a detailed review of the structure of each component be undertaken as it was handcrafted including confirming the appropriateness of the benchmark properties. Even with this extra work, the average cost per valuation was comparable to some of the other country areas where periodic handcrafting was not a requirement.

The results for the first year of this project provide strong evidence for the need for this periodic handcrafting. In Wollondilly some 2898 properties were handcrafted and of those 5.6% were altered by 5% or more from the initial application of the component factor. In Wingecarribee the results were even more dramatic. Of 1904 properties that were handcrafted during 2004, 36% were altered by 5% or more from the initial application of the component factor.

Property Valuation Services who undertook the handcrafting program utilised electronic mapping software to assist in the handcrafting process. The Regional Valuer reported that the application of the mapping program to selected rural parts of the Wingecarribee LGA demonstrated a number of inconsistencies that would have been very difficult to pick up from the representations of property and valuation data otherwise available. He concluded that this confirmed the view that these rural areas were seriously in need of handcrafting and reallocation of components in several areas⁵⁷.

This approach needs to be urgently expanded to other valuation districts.

4.7 Dealing with objections

4.7.1 Incidence of the objections

Julie Walton in her 1999 inquiry⁵⁸ examined the Valuer General's objection rates in relation to a sample of districts and suggested they were one of the possible indicators of the reliability of the valuations. Certainly many contract valuers and contract managers, and even the Valuer General and Chief Valuer, find comfort in the low rate of objections as an indicator of the relative accuracy of valuations issued.

Data about the number of objections and appeals to the Land and Environment Court are presented in the table below⁵⁹.

Table 19 – Objection and appeal outcomes – 1997-2004

Year	No of valuations	Objections received	Objections Allowed	Court appeals lodged	Court appeals settled	Court appeals upheld	Court appeals dismissed	Court appeals pending
1997	2171872	N/A	2356	84	34	31	19	0
1998	2209715	N/A	1291	316	87	167	62	0
1999 ⁶⁰	2250026	N/A	1684	257	80	145	32	0
2000	N/A	N/A	N/A	115	65	22	25	3
2001	2350665	7412	1832	60	44	8	6	2
2002	2370766	8728	1819	50	34	5	9	2
2003	2376979	10350	2023	67	49	3	9	6
2004	2361542	13671	1712*	115	40	36	5	34

N/A (not available)

* 5204 objections finalised as at 30 June 2005

According to the Valuer General, the normal rate of objections in most western jurisdictions is in the region of 1.5 to 2.5%, which makes the NSW objection rates quite low. From 2001-2003, the objection rate averaged .0.37%. For the 2004 valuations program, it jumped to 0.58%.

From 2001 to 2003 approximately 22% of objections on average were allowed. The Valuer General is still processing objections from the 2004 valuation program. Due to the major changes to land tax for the 2005 assessment year, the number of objections has significantly increased. Of the 5204 objections that had been determined as at 30 June 2005, 32.9% were allowed. This does not, however, necessarily indicate a significant increase in the number of allowable objections due to changes in counting conventions.

Prior to 2004, invalid objections (i.e. objections that did not contain any valid grounds of objection as required by s.34 of the Valuation of Land Act or did not contain supporting evidence or otherwise did not comply with requirements of the Act) were registered as objections and then disallowed. For the 1 July 2004 general valuation program an objection screening process was introduced (see 4.7.3 below). As a result, invalid objections that previously boosted the number of disallowed objections were not registered as objections. In these cases the objectors were provided with additional advice on the requirements for lodging an objection and invited to re-submit. Accordingly, comparison of the 2004 allowable objection rate with previous years is limited. At best, an approximate adjusted figure can be deduced for comparison purposes.

Of the 2286 invalid objections made up to 30 June 2005, 949 were subsequently re-submitted in valid format and registered. Of those, 674 related to the 1 July 2004 land values. Assuming that proportion was representative of all the invalid objections, it is possible to treat the balance of invalid 2004 objections not re-submitted as disallowed objections and include them in the number determined to approximate the counting rules that applied in previous years. On that basis, the proportion of allowed objections for 2004 to date is estimated to be approximately 27.8% for comparison purposes. This still indicates a substantial rise in the proportion of allowed objections in 2004.

As the above table demonstrates, relatively few dissatisfied objectors pursue their objections through to appeal in the Land and Environment Court. The costs involved mean there is little economic incentive to do this unless the potential savings in land tax are substantial. An experienced barrister in a complaint to the Ombudsman estimated the costs of a simple contested appeal with both sides represented by solicitor and counsel could easily exceed \$15,000. In order for the landowner to break even, he estimated a valuation reduction of about \$880,000 would be required as an outcome of the appeal to obtain equivalent relief from land tax.

4.7.2 Factors that influence the volume of objections

In a 2004 internal document prepared for the purposes of a funding submission, the Chief Valuer suggested the number of objections received could be influenced by factors such as:

- Significant increases in land values;
- Dissatisfaction with having to pay land tax leading to objections as a protest;
- Attempts to reduce tax liability by achieving a reduction in land value through an objection;
- Low levels of public confidence in the valuation system resulting from and leading to negative publicity;
- Falls in the market level between the time valuations are made at 1 July and when they are published and used early in the following year leading to a misunderstanding that land values should have decreased;
- Inconsistency or leniency in application of rules and discretions in accepting objections that do not address the valid grounds for objection or are lodged outside the statutory time limit
- Delays in processing objections leading to issues being unresolved when new values are issued causing owners to also object to the new valuation.⁶¹

A review of complaints made to the Ombudsman since commencement of this investigation generally supports the Chief Valuer's views. A key issue in 77% of complaints was the significant increase in land values from previous valuation programs. In 28% of complaints a key issue was the amount of land tax and in 32% key issues were the general reduction in the market values in their area and a lack of sales evidence to support the value. Only 12% of complaints raised technical issues related to valuation such as the detrimental impact of particular features of the land, zoning, surrounding developments or grading anomalies in a component.

4.7.3 Objection screening

The *Valuation of Land Act 1916* allows property owners to object to land valuations following receipt of a Notice of Valuation or a Land Tax Assessment. Section 34 of the Act sets out the grounds for objection to a land valuation.

(1) In relation to land the only grounds upon which objection may be taken under this Act are:

- (a) that the values assigned are too high or too low,*
- (a1) that the area, dimensions or description of the land are not correctly stated,*
- (b) that the interests held by various persons in the land have not been correctly apportioned,*
- (c) that the apportionment of the valuations is not correct,*
- (d) that lands which should be included in one valuation have been valued separately,*
- (e) that lands which should be valued separately have been included in one valuation, and*
- (f) that the person named in the notice is not the lessee or owner of the land.*

Written objections are initially assessed to determine whether they meet the requirements of section 34 of the Act. The Act requires objections to be lodged within 60 days of the receipt of the Notice of Valuations or land tax assessment. The last date to object is recorded on the Notice of Valuation.

In December 2004, the *Valuation of Land Act 1916* was amended to require the Valuer General to specify a form in which objections must be lodged.⁶² Previously the Act did not specify the format for lodging objections. There was no restriction on the length of objection letters and objectors were not required to identify reasons for objections or to provide evidence to support claims. A valuation objection form was available but its use was optional. We have been told objection registration was often hampered by hand-written letters that were lengthy, difficult to read and did not address valid grounds for objection.

The new, mandatory valuation objection form is in a format intended to assist people to lodge a valid objection to their land value. In particular the form is designed to aid understanding of the grounds for an objection and provide structure to the objection. The form requires that adequate supporting information should be provided to support any claims for objection. Appropriate supporting information includes evidence of sales surrounding the objector's property or changes to the physical condition or the permissible use of the land. When objectors fail to provide relevant supporting information, the objection is generally returned with a request to provide more detailed information.

While the valuation objection form lists the valid grounds for objection and provides a framed space for objectors to note information supporting their objection, the explanation of what constitutes information on which the objection can be based is limited to "details of sales of land and changes to the physical condition or the permissible use of your land". The valuation objection form or the other publicly available material produced by the Department of Lands on objections does not provide any model examples of frequently used grounds for objection. The valuation objection form also does not offer clear advice about whether additional documentary evidence can be attached and what types of evidence this could include.

Complaints to the Ombudsman indicate that objectors find the presentation of their grounds for objection and supporting information an onerous task. One elderly complainant found the Valuation Objection Form vague and unhelpful and was concerned because she could not access the Internet to try and inform herself of what was required. She had not received any information other than the Valuation Objection Form. Another complainant was upset about the effort that she had to take to provide what she considered additional documentary evidence only to have the objection returned for the second time.

In preparation for the significant increase in objections flowing from the 2004 land tax changes, a centralised Objection Screening Unit within LPI was established in December 2004. Objection Screening Procedures were also introduced in order to guide screening decisions.

Objections received in letter format are returned generally to the objector with a letter of explanation and a Valuation Objection Form. The Objection Screening form must show the reason(s) the letter was rejected. However, the Objection Screening Unit Supervisor can accept a letter of objection where it identifies the property, the valid ground(s) of objection, supports reasons for objection and is legible and in a format capable of being processed efficiently.

Screening staff generally consist of valuation roll maintenance personnel. They screen, register and process the objections for review by the senior valuers in regional centres. Screening staff use a checklist of grounds for objection and a list of possible supporting evidence contained in the Objection Screening Procedures. The only valid grounds

for objection to land value are those in section 34 of the Valuation of Land Act. At least one of the grounds for objection must be identified, unless the objection is to a concession or allowance, in which case the appropriate section on the Valuation Objection Form must be completed.

The Objection Screening Procedures define the specific supporting information required for a valid objection. These include:

- Sales of like properties and how they are related to the subject property;
- How the subject property otherwise relates to the market evidence;
- Physical defects of the land, e.g. flood zone, creek, impact of surrounding development, views, etc.;
- Any changes to the permissible use of the land;
- Evidence supporting the correct area or dimensions of land;
- Evidence supporting correct details of ownership if identified as the grounds for lodging an objection;
- Reasons why land should be valued separately or together as identified in grounds for objection;
- Bases for the apportionment of the valuations.

Information not considered to be valid supporting information includes:

- Any personal circumstances of the objector, other than as a reason for late lodgement;
- The increase in value on its own;
- The objector's liability for rates and or taxes;
- The method used to make the valuation.

Given the consequences for objectors if they fail to understand how they must comply with the Valuer General's valuation objection requirements, it is beholden on him to ensure the grounds of objection are clearly explained, not just listed and the invalid grounds for objection are also explained, perhaps with some examples of acceptable and unacceptable supporting information. Objectors would be assisted if the types of specific information required for a valid objection as listed in the Objection Screening Procedures were publicly disclosed with some elaboration.

In reviewing a sample of objection files for the years 2002 and 2003, it was apparent that many finalised objections would have been rejected under the current Objection Screening Procedures. Of the 29 objections file examined, 13 (49%) could have been rejected as invalid based on the reasons given in the objection and the failure to provide supporting information. Two of these objections had actually been allowed.

Many objectors regard the objection process as a difficult exercise and some even believe it is designed to deter them as the following comments taken from complaints to the Ombudsman demonstrate:

- *The owner will also receive a form letter designed to deter him from objection, let alone appeal. That strategy will succeed in most cases. If the owner objects and uses a registered valuer he has a chance that his objection will be considered.... If the owner simple objects he will receive a form letter rejection.*
- *From what I can make out the Lands Dept will keep forms bouncing back and forth until the home owner drops out from sheer frustration.*
- *As one who is 70 in a couple of weeks, I find preparing an objection time consuming and a bit of a daunting procedure. Many others would just throw up their hands in despair!!!*
- *To object requires energy, time, know how and determination. I am very concerned that the process is flawed, and often inequitable. Each year the preparation of an objection is an onerous task involving review of recent sales in the area, legwork and analysis.*

4.7.4 The objection and appeal service

LPI provides a service to support the Valuer General's statutory role of determining and managing objections to and appeals about rating and taxing values.

The performance of the objection and appeal service is specified in the Service Level Agreement between the LPI and the Valuer General. Delegations from the Valuer-General to enable LPI valuers to determine objections are detailed in Attachment 1 to the Service Level Agreement. The 2004-2005 Service Level Agreement was the first to include detailed key performance indicators and targets. As a result, no information is available to ascertain LPI's performance in previous years.

The current key performance indicators (KPIs) for the LPI relating to objections include:

- Register all objections and appeals within 7 days of receipt of objection or notification of appeal;
- Acknowledgement letter sent to objector within 7 days of receipt;
- Average turnaround time to determine objections less than 90 days from registration
- Adjust land values in Valnet and decision letter issued within 7 days of decision.
- Less than 5% of all objections having the value amended on objection by more than 10%
- Less than 0.25% of valuations being amended on objection by over 20%.
- Less than 0.25% of valuations being re-ascertained.

While the first four KPIs clearly relate to LPI services, the last three KPIs primarily relate to the quality of the original decisions of the contract valuers. While both the Valuer General and the Chief Valuer see them as measures reflective of the quality of these decisions, keeping them as KPIs in the Service Level Agreement means they could be perceived as putting constraints on LPI staff to properly assess objections on their merits. If LPI overturned too many valuations, they could be seen to be performing badly. In addition, having a target of less than 0.25 of issued values being re-ascertained could be perceived as actually discouraging LPI staff from re-ascertaining values of other properties that warrant change following objections that reveal anomalies in surrounding properties. Both the Valuer-General and the Chief Valuer denied that this would be happening.

In evidence, the Valuer-General said:

I mean, one of the things, as I said, that is absolutely fundamental to me, and I've explained it to the staff of LPI, is that transparency is absolutely important and the one thing I've been saying to them is that, you know, if there's a mistake there, we need to know about it, and we need to be able to get it fixed.

The Chief Valuer gave evidence that he believed the objection process was "quite rigorously run by LPI". He said:

...you could argue that the higher the number, the better it suggests that LPI is doing its job ... but I don't believe that there is any feeling – certainly amongst my staff – that because there's this KPI there we'd better not fix these values, because it will push that count up. I'm sure that view doesn't exist.

However the Valuer-General acknowledged to the inquiry:

...there's nothing there at the moment in terms of being able to directly assist us in terms of measuring whether or not there's a deliberate need – you know, a deliberate bent on behalf of the contract manager or the RVs to make sure they stay under the 0.25.

While it was his evidence he did not think this problem was happening because LPI had made a number of re-ascertainties that meant it was substantially above this 0.25 target⁶³, he said he wanted to develop some tools that would allow him to identify how widespread any errors might be.

The Chief Valuer also gave evidence that the objection process was more a measure of the performance of the contract valuers than of LPI. He saw what happened in the court after the objection process as the test of LPI's performance. He said that the Service Level Agreement was up for review and there were measures in the agreement that were not the best or most appropriate.

The Chief Valuer must be advised of value changes in excess of 20% that are the result of successful objections. Past and current contracts have not included penalties for objections upheld where the values amended exceed a certain value. The Valuer General previously sought advice from NSW Supply on ways that enforceable sanctions could be included in valuation contracts. The Chief Valuer gave evidence to the inquiry that the advice for the 2004 program was to the effect that penalties were not likely to be really enforceable. Instead they decided to introduce a compliance scorecard, which could be used to evaluate contractor performance. The scorecard tracks the number of objections amended between 10 and 20% and by over 20%.

In any event, keeping the last three targets as KPIs in the Service Level Agreement should be reviewed.

4.7.5 Delays in processing objections

Implicit in the *Valuation of Land Act 1916* is an expectation that objections should be determined within 90 days as objectors automatically gain a right to appeal to the Land and Environment Court if an objection is not determined in that time on the basis of a deemed disallowance. The Valuer General has included the 90-day target as a KPI in the Service Level Agreement with LPI.

Complaints to this Office indicate that in the 2002-2003 and 2003-2004 programs, LPI would have had considerable difficulty meeting the key performance indicator of 90 days turnaround from the registration of the objection. In fact many objections were taking longer than 12 months to finalise.

In 2003-2004 LPI processed 11,339 objections only 25% of which were completed in the target period of 90 days⁶⁴. The average cost of processing these objections was \$280 per objection due to the individual nature of the review and the requirement for a site visit. LPI employs 31 valuers (21 district valuers and above and 10 valuers) and in 2003-2003 42% of LPI valuers' time was allocated to objection processing.

In the 2004-2005 program, in order to improve the turnaround times of objections, and in order to handle the expected significant increases in objections, a number of contracts were let with independent valuation contracting firms not involved in the valuation program. Where they are used to supplement the resources of LPI valuers, the contract valuers conduct the initial reviews and make recommendations to LPI about allowing or disallowing objections. LPI provides the contract valuer with:

- The objection and other information supplied by the objector;
- A printout of LPI data relating to the property;
- A component valuation report showing sales information for relevant component;
- Relevant Local Government Area detailed sales analysis and associated sale map(s).

The Chief Valuer gave evidence he was expecting improvements from the new arrangement with independent contract valuers. He told the inquiry that, although the times for finalising objections had not achieved the 90-day turnaround on all objections as yet, there was certainly a lesser drain on the time of LPI valuation staff than if they actually went out and inspected properties and reviewed objections.

4.7.6 Processing of objections

Objections that are based on valid grounds and comply with the minimum required supporting information are registered in Valnet and acknowledged by LPI roll maintenance staff within 7 days. At the time of registration, an objection file is established including an objection control sheet, the objection letter, the relevant component benchmark report, the deposited plan and/or cadastral plan, a title search; and a Valnet property details report indicating the values as recorded on the Register of Land Values.

In a letter Ombudsman⁶⁵ the Valuer General said he believed:

The achievement of both public confidence and my desired philosophy for a valuation system which is 'Customer Focused and Outcome Driven' cannot be acquired unless the four linking pillars are embedded within the valuations system, i.e. the valuation system must uphold the principles of:

- *Accountability*
- *Consistency*
- *Independence*
- *Transparency*

For the public of NSW, the Valuer General's objection processing system is one of the key means by where the fruits of this philosophy should be revealed.

The Valuer General must ensure that objections are reviewed by a valuer different from and not subordinate to the original valuer. Section 35B of the Valuer of Land Act 1916 states:

(2) If the Valuer-General delegates the functions conferred by this section, the delegate who considers the objection must be a different person from, and not subordinate to, the person who made the decision against which the objection is lodged.

At LPI, either the district valuer or another senior valuer reviews objections. The district valuer is generally the contract manager for a number of districts. The contract manager approves the component factors and the market analysis report on which the valuations were based.

The Valuer General gave evidence that for the 2002 and 2003 programs, district valuers reviewed most of the objections but after he commenced in the role, he employed a few independent contract valuers to do the reviews. When independent contractors review the objections, they usually go to the regional valuer for final consideration before issue.

The review should be a completely fresh and independent look at the original valuation. The value of the property is individually considered in comparison to the market evidence. The review generally involves a physical inspection of the property⁶⁶, consideration of relevant sales evidence and, where necessary, obtaining additional information from the original valuation contractor to determine what was taken into consideration when the property was valued.

The *Rating and Taxing Valuation Contract Management Procedures Manual* states that where an objection to a notice of valuation has been lodged, a contract manager may request all records or information held by the contractors. The request must be submitted on a Contractor Inquiry Form to the Contractor where there is any question regarding, the basis of the valuation, the methodology used by the contractor to establish the value, claims by the objector about zoning or physical features that may not have been considered in the valuation. It is not a request for the contractor to inspect or further investigate the property. No other advice about the processing of objections is contained in this manual.

To find out what steps objections reviewers were actually taking, we examined a sample 29 LPI objection files.⁶⁷ We found:

- 5 files indicated that an inspection had been conducted;
- 11 files indicated that the owner had been contacted;
- 6 files indicated that information was obtained from the initial valuer;
- No files contained Contractor Inquiry Forms;
- 5 files contained sales lists or schedules for the previous 12 months sales;
- No files had information about prior objections for the same property.

It is often the case that by the time objections are processed there is significantly more information available about sales transacted close to the 1 July base date. Consequently the reviewing valuer has more evidence available to judge the true value of land in the area at the time they consider the objection. Our review of the objection files confirmed this:

- 16 files indicated that additional sales had been considered;
- 12 files indicated which sales were relevant to the recommendation.

The reviewing valuer then prepares a brief report including a recommendation to allow or disallow the objection. This could include any information about other properties that might be affected by the recommendation. However, our review of the objection files found:

- only 19 files made a clear recommendation in the valuer's notes on the objection control form;
- only 2 files indicated whether or not other properties needed to have values altered as a result of the outcome of the objection.

Another senior LPI valuer, usually at regional valuer level, considers the objector's issues and the reviewing valuer's report before making a final determination. While the regional valuer is a more senior position to the district valuer, the system does not guarantee that the regional valuer determines every objection file. Our review of objection files revealed:

- 10 files were reviewed and signed off by the same district valuer;
- 5 files were reviewed by a district valuer and signed off by another district valuer;
- 7 files were reviewed by a contractor, checked and a recommendation made by district valuer (also contract manager) then determined by the regional valuer;
- 1 file was reviewed and determined by a valuer;
- 6 files did not have a position title for the decision-maker and it was not possible from the signature to determine whether the person was a regional valuer or a district valuer or a valuer.

One of the recommendations of the Walton Report was that the contract manager or a person of equivalent rank should not deal with objections lodged because contract managers approve the market analysis report recommendations from the contract valuers.

While I have reached a number of conclusions that agree with earlier observations by Walton, I take a slightly different view on this issue. Even though contract managers approve the market analysis report recommendations for component factors, they do not approve particular values. In any event, not all values are reached by applying a component factor because of the need for handcrafting in certain circumstances.

Excluding contract managers and persons of equivalent rank from dealing with objections restricts the process to regional valuers of which there are only six. Given their other duties, this is an unrealistic and in my view unnecessary requirement.

While identifying some record-keeping deficiencies, I was well satisfied that district valuers approach objection processing with a professional and open attitude.

Despite Walton's recommendation, I consider there is sufficient separation between the initial decision-maker and objection decision-maker for contract managers to provide a useful input into the objection assessment on the basis that it will inform them of emerging issues relating to the effectiveness of the contract valuers' work. This immediate feedback on the quality of valuations has an obvious benefit within a quality assurance framework.

Some of the objection control sheets lacked the legible names and positions titles of decision-makers on the documentation. In the decision section there is no specific space for the decision-maker to record their position title, only to note the registered valuer's number. While it is important to know that the decision-maker is a registered valuer, in the case of the final determination of an objection, the position title is of critical importance. When the only information about the decision-maker is a registered valuer's number and an illegible signature, it becomes impossible to determine the identity and role of the decision-maker. Many decision-makers had noted their position title in initials in the margin of the document.

Allowance should be made on the objection control sheet for the position title as well as the valuer's registration number.

4.7.7 Determining objections

The objection must be allowed or disallowed in accordance with section 35B of the Act. Once the decision to allow or disallow the objection is made, it is recorded on the Objection Control sheet, along with the reasons for the determination.

Our review of objection files revealed:

- 18 files contained valuers' notes that gave some reasons for disallowing or allowing the objection;
- only in the 12 files in which the objections were allowed were reasons for the determination provided by the person making the decision on the objection.

Some of the reasons given on objections files were merely simple statements such as "Value appears excessive" or "suggest value of \$516,000. See sales list comparison attached". Often the section on the valuer's notes on the objection control sheet just recorded a physical description of the land.

The inquiry sought the views of the Valuer-General and the Chief Valuer on whether there was room for more discipline in recording the actual reason(s) for allowing or disallowing an objection.

The Valuer-General gave evidence there was definitely room for more detail. He believed the ideal situation was to have the whole process recorded electronically, from the original value, what sales were used that related specifically to the property in question, through to the objection and how the determination was reached. It was his evidence the present system involved manually obtaining a large amount of information, which added to the process, so he understood why they just referred to it on the objection control form. However, it was his view that under the requirements of the *Freedom of Information Act* and in a court situation, the valuer needed to be able to relate back to the specific sales used for the valuation of a property.

The Chief Valuer gave evidence it was fundamental to provide reasons. He said:

...the purpose of the objection review was to not only address the issues raised by the landowner, amongst others, but to rationalise the decision made on the objection.

From our audit of a sample of objection files, it appears that this expectation is not being currently met. In many cases, actual reasons for allowing or disallowing an objection are simply not included in the records. Reliance is placed on the determining valuer 'reading' and understanding the import of the source evidence summarised or attached to the objection control form.

4.7.8 Notification of objection determination

The objector must be notified in writing of the outcome of the objection and the Register of Land Values updated if required.

If, as a result of a successful objection, the Valuer General decides to re-asertain the values of other properties, a new notice of valuation must be issued. The Valuer General includes a letter of explanation with the new notice of valuation. A full right of objection attaches to such re-asertainments.

Most of the notices of determination on the objection files we reviewed provided little information (at the most three paragraphs that could be only regarded as brief reasons) to the objector and few of them dealt with all of the issues raised in objections. Our review revealed:

- 21 files used only standard paragraphs
- 5 files had additional composed explanation that went some way to addressing the objector's issues;
- 3 files had no notice of determination on file;
- 1 notice of determination disallowing the objection gave no reasons for the decision;
- 1 notice of determination included a paragraph giving the sales relevant to the determination;
- No notices of determination or files indicated that sales relevant to the decision were attached to the determination.
- No notices of determination identified the person making the decision or the decision-maker's position title.

It was not uncommon for objectors to have taken considerable effort to detail their issues in their objections and to have been sent two or three two-line paragraphs in addition to the standard appeal rights as explanation for disallowing the objection. We note that in response to our written questions in explanation of how he intended to improve communications with the public, the Valuer General said he was currently reviewing the standard paragraphs in frequently asked questions and issues in objections. It would seem appropriate that more than a plain English approach to this review is required.

None of the notices of determination to objectors identified the name of the decision-maker or position title on the document. Objectors receiving an official notice of determination are unable to identify on the letter the name of the decision-maker. The signature at the bottom is not made above a clearly typed name. Also the name of the decision-maker is not included in the objection reference details below the letterhead.

In the circumstances, it is impossible for the objector to initiate direct communication with the decision-maker and it does not foster confidence in the objection process.

4.7.9 Guidance for processing objections

At the time of writing this report, there was no Objections Procedure Manual to guide the reviewing valuer. Historically, objections have been processed on the basis of well-known practice rather than a formalised procedure. However, a draft Objections Procedure Manual was prepared in May 2004, but is still to be finalised.

A reading of the draft Objections Procedure Manual gives an indication of how the Valuer-General and LPI believe objections should be processed. The steps include:

- Conducting a desk audit of the objection to decide if inspection is required or it is possible to make a recommendation.
- Obtaining documentation to proceed with review.
- Sending Contractor Inquiry Form if the objection raises a question about the basis of the valuation, methodology of the contractor, zoning, physical features not considered in the original valuation, additional sales or leasing, or aspects of the use of the property that may affect its value such as carrying capacity, clearing, irrigation or water use.
- Inspecting the subject property and taking photographs.
- Inspecting sales properties and making inquiries about town planning, zoning, development and heritage issues.
- Interviewing landowner if requested or necessary.
- Completing the objection report, and making a recommendation.
- Recording the recommendations on the Objection Control sheet along with the reasons and the recommended Valnet standards paragraphs for the notice of determination.
- Submitting the file to the appropriate officer for determination.

Some of documentation required to proceed with a review should included papers from any prior objection, previous 12 months sales, lease information, town planning, zoning, heritage, development control plan, or ordinance information, deposited plan, cadastral plan, title search, Valnet information, sewer plan and maps.

For previous valuation programs when LPI staff processed objections, there were no specified requirements for communications between the original contract valuer and the LPI reviewer. It was up to the LPI valuer to determine whether and how they obtained any information for the objection from the original contract valuer.

The draft Objection Procedure Manual is again informative about what would be useful to the decision-maker when the objection reviewer provides a recommendation to LPI. The Manual requires a worksheet to be used. It should contain the following:

- A brief physical description of the land
- Comment on any matters raised by the objector
- A brief reference to the most recent sales.
- A Statement as to whether the valuation is correct
- Recommendations as to the appropriate standard paragraphs for LPI's response
- Where value is considered incorrect, a statement as to the correct value
- A digital photograph of the property and further photographs of any physical items/issues raised by the objector.

When the draft Objections Procedures Manual was written, no actual objection worksheet was drafted. However, several regions have implemented their own worksheets that have been used to process objections. As yet there is no standard worksheet.

4.7.10 Objections as a quality control measure

The Valuer-General considers the objection review mechanisms as part of the quality control process. The grounds for the objection and reasons for value changes are recorded on Valnet and copied into COGNOS, a business analysis tool, which can be interrogated by LPI contract managers to provide an analysis of why changes to values are being made on objection. There does not appear, however, to be any systematic analysis of objection trends as a means of monitoring the standard of valuation services provided by contract valuers.

Our review also highlighted a number of other potential discrepancies in the current arrangements.

4.7.11 Objections and the need to revise values in other valuation programs

In recent years, the long timeframes for finalising objections in one program has had consequences for the valuations made in the next program. We received a number of complaints raising the issue of new valuations being generated before existing objections have been finalised. Complainants recounted instances where the valuation in the later program was not adjusted to reflect the revised base value when an objection was upheld. This forced them into making serial objections on the same grounds.

In evidence the Chief Valuer concurred that there were some circumstances where this could occur but he believed basically an objection to an earlier valuation amends the next valuation. He thought it was a reasonably common process for the later valuation to be re-ascertained at the same time as the earlier valuation.

There is, however, no administrative process, whether on the objection control form or the objection file or in Valnet requiring this type of check to be made and the subsequent revision action to be recorded.

In evidence the Valuer-General said he had spoken to regional valuers about whether there were any checks and balances in the system to flag where an earlier objection was still being handled at the same time as a new valuation was being issued in the next program. He was advised if the regional valuer had upheld a 2003 objection then they would always go and look at the 2004 valuation. It was, however, up to the regional valuer to remember to check.

In evidence, he said:

...in actual fact there is no – there's nothing in the system actually to do that. It's just, you know, on the goodwill of the individuals concerned to go and check it. So I actually requested immediately following that meeting... that I want a trigger put in place that when a review is undertaken it automatically brings up a requirement to check the 2004, or you know, the next valuation, or in some cases it could be two valuations.

The Chief Valuer also gave evidence of the need to improve the way this aspect of the objection process is managed. He said:

Should it be done better? I think it probably could and, you know, one of the things we're contemplating there is having an edit check, if you like, put into Valnet, so that if a valuation is changed on objection and there is a subsequent valuation here, that it needs to at least be reconsidered.

The Objections Procedures Manual should be suitably amended to require the mandatory re-ascertainment of any later issued valuation where an objection is upheld.

4.7.12 Objections as a means of identifying problems with valuations of other properties

Successful individual objections do not necessarily indicate that a valuation problem extends beyond that property, but they sometime do. The Valuer-General's only legal obligation is to look at the particular property the subject of the objection and make a determination about whether the valuation is correct or not. However, it is administrative good practice to use objections to identify other anomalies, if the objection process is to properly act as a quality assurance mechanism.

If a valuation that may exist is produced by the component factor method and in considering the objection it is decided the sales did not support that valuation, or an individual valuation is out of line with other values around it, there do not seem to be any clear procedures or protocols that require the reviewing valuer to look at whether other properties in the component have similar, anomalous values.

All the district valuers/contract managers interviewed for the inquiry told us the decision to look into the values of other properties was a matter for their discretion. One contract manager put it this way:

No. There's no procedures that require me, other than me. If I think that the adjacent properties are in the same boat, I should review those valuations. If I think that a general area is in the same boat, I should review those valuations.

Another contract manager said:

I don't know that there is a protocol involved. It's more of a – the situation is how bad is it, how – you know, how far have we reduced this, or is it just a one-off..... Or it could be the case where two or three objections get lodged and we realise that there is a problem through this area and it would not be fair, if you like, to leave the value levels where they are. And there are sections under the Act where we can go through and re-ascertain pockets, areas where it's wrong.

When it was put to the Valuer General that there did not appear to be any rigorous system in place for checking related valuations when there was a successful objection, he responded:

I would hate to think that had occurred. I can just think of a couple of examples I dealt with last week where there were some issues there where we ended up amending a whole lot of valuations around it because of one objection, and it was too high, and they have gone back and reviewed it and they have ended up recommending to me that there are a number of what we call re-ascertainments undertaken around that particular area.

He further said that two areas had been re-ascertained following successful objections, one of 65 properties and another of close to 100 properties because of a wrong factor to a component. He said:

...and that's the beauty of the objection process, it actually picked it up for us, but what it's allowed us to do now is to develop other checks and measures to put in place next time to make sure that doesn't happen again – some edits in the system to be able to pull that sort of change up.

The Chief Valuer said there were cases where the objection process had pointed to a more systemic problem in a locality. He said following the 2004 valuation program re-ascertainments in Minnie Water had generated a great deal of media attention but there were also areas around Dorrigo and on the western part of Lake Macquarie where the need for re-ascertainments had been identified as a result of objections.

However, in the absence of procedures that require district valuers to consider the impact of grounds for successful objections on surrounding properties, and to encourage corrective action where needed, there appears to be reluctance on the part of some contract managers to use their discretion to identify and correct related anomalous values.

A number of contract managers interviewed raised the problem of identifying the extent of a valuation problems uncovered through an individual objection. From the point of view of the contract manager, the concern is where do you stop checking on values to determine if they have been affected by the problem. One contractor put it this way:

When you do the objection, you are doing the objection under the Valuation of Land Act. Someone has appealed against their land value, so that's what you are determining. If I came across a property that was out of line with all the others, okay, and I may say to the contractor, "You need to review the value levels in that location," there is a section under the Act where the Valuer General can amend valuations, but that would be pretty rare. You don't try and handcraft around if you find a problem – do you know what I mean? Because, like, where do you finish? If you handcraft those down that street then you follow down that street; pretty soon you are doing, you know, 3,000 entries.

Again, the Objection Procedures Manual should require those determining objections to consider if a particular allowed objection has implications for surrounding properties. There should be onus to correct any common defective valuations and not simply refer matters to contract valuers for attention in the following valuation program.

4.7.13 Objections and the revaluation of benchmark properties

If the Valuer-General receives an objection to the value of a benchmark property, it is handled like any other objection. However, if the objection is upheld, there could be implications for the component factor applied to other properties in the component.

When contract valuers provide market data files to LPI, the component benchmark reports are included. Part of the standard documentation for an objection file is the component benchmark report but there is no highlight on the objection control sheet to flag the property as a benchmark. While not a difficult fact to determine, it does rely on the person reviewing the objection to make the link. There is also no guidance in the draft Objections Procedure Manual to cover this possible event.

In evidence, the Chief Valuer said that it was reasonable that this situation be included in the Objections Procedure Manual. Due to the implications that potentially flow from a revaluation of a benchmark property, this obviously needs to be covered.

4.7.14 Objections as an evaluative tool for quality control

The capacity of the Valuer-General and the Chief Valuer to obtain a reasonably comprehensive analysis of valuation reliability, performance of contractors and effectiveness of processes from the objection process is limited. Valnet only provides a rudimentary search facility to obtain information about the number of valuation changes made, the numbers that have increased or decreased, and the numbers of objections in a particular area.

The Chief Valuer gave evidence that the current evaluation system relies basically on the input of the regional valuers as the key people determining objections in their regions. He believed they would see patterns emerging and identify actual or potential 'hot spots'. Despite the fact there is no formalised process or system level approach to analysing objection trends, he believed reliance on the views of key personnel was a reasonable system.

Given that the Valuer General has a statutory duties to maintain the standard of valuation services and make assessments of the compliance of contract valuers with procedural and other requirements of the Act, Regulations and other application valuation service controls, one would expect a more sophisticated monitoring and reports of objection trends across the State than currently exists.

In evidence, the Valuer-General suggested the introduction of Valmap would be a significant improvement to enable better analysis of objections and other trends.

4.7.15 Objections as an educative tool for quality control

Section 35B(2) of the Valuation of Land Act 1916 prevents the Valuer General from delegating the consideration of objections to the same person who made the original valuation decision. However, we received mixed views about the value of sending objections back to the original contract valuer.

One contract manager argued it was an important educative tool to do this. In his region as a trial they had started sending objections back to the original contract valuer to obtain a comprehensive briefing about the property and how the original recommendation was reached. He said this enabled the contractor to see where the original valuation(s) may have been incorrect.

In evidence, the Chief Valuer said while one of the strengths of the objection system was that it was a completely independent review, one of the flaws of the process was that the contractors have knowledge of the properties and the market in the area that might not be apparent to the valuer reviewing the valuation. He also believed that through reviewing objections the contractors would learn a lot about the quality of the valuations in the area and where the problems were.

The Valuer General gave evidence that in the majority of western jurisdictions the contractors that undertook the original valuation also deal with the objections and there were few problems with this. He believed it was possible to present the issues that the objector raised to the contract valuer, ask them to provide comment on those issues and say whether with knowledge of the objector's issues there would have been any impact on the original recommendation.

At present, contract managers decide how much, if any, information to provide to contract valuers about anomalies that objections bring to light. However, there are no requirements in the *Rating and Taxing Contract Management*

Procedures Manual or the draft Objection Procedures Manual for contract managers to provide any information to contract valuers about changes as a result of objections. There was evidence in a few of district files that we reviewed that some contract managers do communicate anomalies and other information from the objection process to contract valuers.

In evidence, the Chief Valuer said:

I guess that's one of my concerns in the process, that sort of relies on someone actually sending these details to the contractor where things have changed. Yes, that certainly happens in many places. Whether that happens with every objection that's changed, I certainly couldn't say that.

The Valuer General has established a project committee of regional valuers and district valuers to develop proposals for improvements to valuation management and reporting processes. In a letter to the Ombudsman⁶⁸ the Valuer General provided information about improvements proposed by the committee for the 2005 and 2006 valuations programs. In relation to objections, these proposals included:

- Developing an objection report which contract managers would produce after an objection has been reviewed where the land value had been redetermined or re-ascertained advising the contractor of the need to investigate whether the land value of adjacent properties within the locality needed to be adjusted.
- Requiring the contractor to provide the contract manager with a full report of their findings after investigation/inspection of the locality.
- Enhancing Valnet to flag all properties that had objections registered and allowed.

These are sensible and needed improvements and I endorse them.

4.7.16 Information provided to potential and actual objectors

There is no express provision in the *Valuation of Land Act 1916* for the Valuer-General to supply any information to actual or potential objectors in the course of dealing with objections. However, there is a common law duty to observe procedural fairness and to this end the Valuer General must provide relevant information.

In the past, when objectors sought information about the basis of their valuation before they lodged an objection, they would generally have been put through to a contract manager. With expected substantial increase in objections flowing from the 2004 land tax changes, LPI contracted the services of a call centre in early 2005 to deal with frequently asked questions and to screen initial inquiries. The call centre issued objection forms and was able to answer general process questions. More complex inquiries were still referred on to district valuers.

Every contract manager who gave evidence to the inquiry said when dealing with calls from potential objectors they would provide a list of sales for the suburb only if the objector actually asked for it. There was a general view also that it was not useful to supply objectors with a sales analysis or too much information because that would only generate confusion and lots of questions from people who would not understand what they had been given.

Two contract managers gave evidence that in their experience most callers didn't really care about the sales evidence. One contract manager was of the view:

...most people don't really care about the evidence. Some people will say, "Well, what sales did you use", but they are really in the minority. Even educated people, generally, talk more about the increase and, you know, why it has gone up so much, or "land tax is costing me a fortune", rather than saying "what about the sale in Johnson Street?" That doesn't happen very often. Some people do. They will bring up sales. But it is rare.

However, there are objectors who seek information about how the valuation was determined, and in more detail than just general sales lists.

The complainant's firm, David Landa Stewart, lodged an objection on behalf of a client on 6 February 2004 to a valuation in the 2003 valuation program. Attached to that objection was a questionnaire seeking a detailed response, which they claimed they needed to properly consider their client's position and to make further submissions on the objection. The objection letter also contained a request to not determine the objection until the requested information was supplied.

The information was not supplied and the objection was determined as part of the normal schedule. Following notification that the objection was disallowed, David Landa Stewart again wrote to the Valuer General reiterating the request for the information. The district valuer supplied a schedule of sales provided by the contract valuer for the original valuation that had been reviewed again for the objection. The most relevant sales were highlighted. It is curious that this relevant information was not supplied to the objector at the time of the original request for information but only as additional communication after the objection was finalised.

In response to our written questions, the Valuer General advised that over the past five years David Landa Stewart had made numerous requests for information via questionnaires. In 2000, the then Valuer General sought an opinion from the Crown Solicitor as to the obligation of the Valuer General to provide the requested information to objectors as part of the objection process. The Crown Solicitor advised there was no obligation to provide the information sought in the questionnaire apart from information that would be relied upon by the Valuer General in determination of an objection. The Crown Solicitor also advised this would involve the provision of relevant sales information, but did not include information as to the mass appraisal procedure or process.

In summary, the questionnaire, containing 11 questions, sought information about the methodology of their client's valuation, i.e. was it handcrafted, or made by the component method, the multiple factor method or some other method, the component code or sub-component code for the property, a list of addresses, values and copies of valuations for the benchmark properties for the component, the last date the property was handcrafted, whether the valuer took into consideration the outcome of the High Court's decision in *Maurici v Chief Commissioner of State Revenue 2003* when determining the factor to apply to the component, a list of results of all successful objections or appeals for properties in the same component and what amendments were made as a result of successful objections and appeals, details of comparable sales relied upon to support the value, information about whether concessions or allowances had been granted for the property and whether the Valuer General knew of any concessions or allowances that could be claimed for the property.

We asked the Valuer General whether the information was readily available in records held by himself or the Department of Lands, and whether there any legal, policy or resource constraints that prevented acceding to such requests from objectors. His answers indicated all the questions except those relating to the consideration of the High Court decision and the details of the comparable sales were not relevant to the processing of the objection. The Valuer General believed that no benefit was to be derived by the objector endeavouring to resolve an objection through using the majority of the information requested in the questionnaire because it was not considered in processing the objection.

Not all the requested information was held in the Valuer General's records⁶⁹ and fulfilling such a request obviously had resource costs that were difficult to justify in the circumstances.

The Crown Solicitor's advice to the Valuer General in 2000, which would apply also to the 2004 questionnaire, was:

Procedural fairness does not require the person affected by a decision to be provided with material which the decision maker will not be taking into consideration. It is important to note that the ground of objection is that the value assigned to the property is too high or too low not that the procedure used for the valuation was flawed in some way.

In the inquiry, the Chief Valuer was asked whether if people asked for component reports they would be supplied and whether there was benefit to objectors in obtaining information such as in the component report. In evidence, he said:

Yeah, if people ask for them, we would provide them. Don't get me wrong, I don't see them as being something to be kept secret, but I just don't think they are particularly helpful to people usually in trying to understand whether their valuation is correct or not. I think that what tends to happen when we provide those details is that people become very focused on the process around making a valuation rather than considering does the land value of my land actually represent what it's worth which I think is one of the benefits of the general valuation sales report....

All the contract managers in their evidence held similar views to the Chief Valuer that the additional detail merely served to distract the objector from the issues that are really relevant.

In July 2004 a policy relating to the provision of information to objectors⁷⁰ was introduced in response to increasing requests for information from objectors and potential objectors and to the amount of detail being requested about how valuations are made. Amongst other matters, the policy allows for the provision of certain information held on the Register of Land Values, comparable sales used to value a property, where appropriate comments on market movements from the sale date to the relevant date of valuation and any relevant comments on a comparison of the sale property to the subject property.

Also in 2004, as part of enhancements to Valnet, a new General Valuation Sales Report was developed. The report shows the various sales within a particular postcode/district within the last 12 months. When objection or inquiry letters are received requesting the number of comparable sales used in the valuation process the report is attached to the acknowledgement letter.⁷¹ All the contract managers gave evidence they either knew of or had sent out sales generated by this report.

The Chief Valuer gave evidence that the General Valuation Sales Report does not show the adjusted land value but only the basic sales details because they are publicly available. However, he conceded that without the ability to deduce the actual land value of those properties, in order to compare their own property against other land values,

the report does not provide the public with the information it really needs. He undertook to include the analysed adjusted land value as an improvement in the report.

He also gave evidence that they had some feedback that the report was of assistance with judging whether a valuation was reasonable or not and he believed its real use was showing the public their valuations did not just come out of the air.

In response to our written questions, the Valuer General signalled further enhancements to the provision of information to objectors and potential objectors. These included:

- Making available on the Department of Lands website more information as to how the valuation of an individual property has been made. The intention is for the public to be able to view additional component information and specific sales that have been used to arrive at the valuation of their property. Implementation is planned for 2005-2006.
- Better access to market information for the public, including general sales statistical information. Implementation is planned for late 2005-2006.

Again, these are sensible initiatives to provide more comprehensive information to potential objectors and I endorse them.

5. Conclusions

The purpose of the component system of mass valuation is to provide an equitable and efficient appraisal of all property for use in rating and taxing assessments by state and local government agencies. Each year the Valuer General issues approximately 2.4 million valuations. It would be both economically and logistically impossible to prepare those valuations by the traditional valuation methodology. As previous inquiries such as the Nile and Walton inquiry have found, the use of a system of mass valuation is inevitable and unavoidable in these circumstances.

The complainant has alleged that the current component system of mass valuation is in “meltdown”, that the system has become “totally corrupted and completely unreliable”. He also claimed that there has been “a total loss of control by the Valuer General in administering the system and producing credible values”. This investigation of the quality assurance measures currently employed by the Valuer General has not led me to conclude that these claims are correct. I am satisfied that the basic methodology underlying the component method of mass valuation is generally sound. It is capable of producing estimates of value within a reasonable margin of error for the majority of properties and theoretically is a self-correcting system so that it should converge to the true values over time. I am also satisfied that the quality assurance framework in place is reasonable, however, it currently has a number of weaknesses in its implementation, most of which are a product of resourcing and scheduling issues. This means the system is currently producing an uncertain number of values that have unacceptable margins of error. The dilemma for property owners is that it is impossible to know whether their particular valuation is sound or not.

This dilemma is well captured in a comment recently made by a central coast ratepayers association in a letter to the Ombudsman following the re-ascertainment of a number of properties in the Lake Macquarie area. This occurred after objections alerted the Valuer General to some anomalies in the valuations in the area:

...several of our members advise they recently received a letter from the Valuer General. In that correspondence it was indicated that due to the number of complaints from several areas on the Western side of Lake Macquarie it was considered necessary to conduct a review in those areas of the valuations issued with a base date of 1 July 2004

That review obviously found a number of errors and many valuations were reduced by as much as \$75,000 to \$100,000. In some instances this represented a 20% error.

On one hand the Valuer General claims that valuations are correct but clearly situations such as this brings into question the entire system being used if it can result in errors of this nature.

Whilst admitting these errors exist in some areas poses the question that they likely exist across the board. Furthermore, it demonstrates a lack of credibility in the system as a whole and while the Valuer General can claim a degree of fairness to those that received a reduction in valuation it leaves many more property owners dumbfounded with little faith of a just determination.

What is more surprising is that the Valuer General failed to demonstrate openness by not disclosing the nature of the errors discovered in the first place that led him to make the number of revised valuations. This leaves most property owners outside the selected areas totally bewildered.

Clearly it was a pleasant surprise welcomed by those who received a reduction in their valuation as that will flow onto a reduction in their rate bill for the next several years but leaves the other 99.9% wondering⁷²

The system certainly produces valuations that are far less precise and reliable than the majority of citizens probably expect. As one contract manager said in his evidence “the valuations that we supply are for rating and taxing. I wouldn’t buy the land based on a valuation we supply”.

While accepting there are some limitations in the reliability of the available statistical information based on adjusted analysed land values from sales, it is still the best evidence we have available to provide an insight into the general level of accuracy and uniformity of issued valuations. While percentage error statistics such as those detailed in Tables 14 and 15 suggest at least two thirds of issued values fall within the 15% margin of error that appears to be universally recognised as an acceptable standard, approximately one third fall outside this standard. As shown in table 15, one in six valuation districts appear to have more than a third of their sales evidence with percentage errors greater than 25% and almost a quarter of the valuation districts had more than 10% of their sales properties showing percentage errors greater than 40%. To the extent that these results reflect likely margins of error in issued valuations, most people would consider these results to be unacceptable for the system used as the basis of all local government rating and land tax assessments.

While the range of properties that are the subject of objections is unlikely to be representative of all valuations issued, the fact that at least one in five objections resulted in the valuation being overturned in previous years, and that over

one in four of the objections to the 2004 valuations determined to date have been allowed, itself reflects poorly on the general standard of accuracy achieved.

More needs to be done to fine tune the process to encourage a greater level of accuracy and confidence in the valuations entered into the Register of Land Values.

In diagnosing what is contributing to the production of anomalous values a number of key issues arose from our examination of the system.

5.1 The deterioration in the quality of base line data

It is clear that the effectiveness of mass appraisal systems is critically dependent upon the accuracy of the base line data relating to each property. If that data is wrong, or becomes wrong over time, the values calculated from it will also be wrong.

It is generally accepted that the cumulative application of factors over time leads to the distortion of the relativity of values in an area and that the base line should be revisited and reviewed periodically. International best practice guides suggests this should happen at least every six years⁷³ at a minimum. In New South Wales, we have now gone for sixteen years without any systematic review and correction of base line valuation data. Especially in those districts where there is a diversity of property types and value ranges, and those where there has been a significant value change as a result of a volatile property market in recent years, the probability of distortions in the relativity of values is high.

The degree of discretionary handcrafting and component review and rationalisation that is undertaken from year to year by contract valuers is insufficient to provide the degree of assurance of the accuracy and quality of the base line data that a system of mass appraisal requires. There needs to be a regular, structured program of handcrafting and review of the structure of components to 're-set' the base line data. This is recognised in other Australian jurisdictions, a number of which require certain percentages of properties to be re-inspected each re-valuation.

The current pilot program being conducted in the Wollondilly and Wingecarribee districts provides a reasonable model for how such base line reviews may be conducted. There may be other approaches that should be explored. However, there is an urgent need to extend the systematic review of base line values and component structures to the majority of districts in NSW. There should be a strategic approach to such a program giving priority to those districts for example where the statistical measures indicate high levels of non-compliance with quality assurance standards, where there are high levels of successful objections, or where value changes have been most pronounced. The Valuer General should explore the feasibility of offering variations to key existing contracts to cater for such additional services and progressively introduce the requirement for these additional services into new contracts as they become available.

The increased costs of valuation contracts requiring systematic handcrafting is likely to be partly or fully balanced by increased rating and taxing revenues that would flow from values that more accurately reflect market values. In any event, confidence in the whole valuation system needs to be restored and the increased cost of these varied contracts is relatively negligible when it is considered that the system provides the basis of raising more than \$1.5 billion in local government rates each year⁷⁴ and \$1.29 billion in land tax⁷⁵. Given that most variations indicated by the percentage error and MVP data suggest undervaluing is the predominant feature of the current system, even increasing accuracy by getting values 1 per cent closer to true market value is likely to significant increase government revenue.

While it would be desirable to see the extension of this program implemented in a great many districts as soon as possible, such a move has significant resource implications for the contract valuation firms. During the investigation a number of witnesses reflected on the fact that the pool of valuers experienced in rating and taxing valuation is very small and that few if any people have been trained in such valuation methodology since the re-organisation of the Valuer General's Department in the early 90's⁷⁶. The number of people entering the valuation profession also is said to be dropping. These factors may limit the feasibility of extending the program as quickly as needed. However, an aggressive target should be set such that at least a third of valuation districts are completely re-assessed within five years.

5.2 Inadequate time to undertake valuations

While it is entrenched in legislation, the setting of the base date is arbitrary. It is currently set as 1 July in each valuation year. Ideally rating and taxing assessments should be based on timely data. It is understandable why people would feel uncomfortable about paying rates and land taxes based on land valuations struck at a remote date. The proximity of the valuation base date to the time rating and taxing assessments are struck, however, needs to be balanced by the consideration of how that proximity affects the accuracy of the valuations.

The *Procedures Manual for Contract Valuers* says “ the most important part of the valuation process is the interpretation of the market as at 1 July. No amount of valuation skill will overcome an inadequate analysis of the market”. The best evidence of the market at the base date comes from sales transactions close to that time. Due to the time lag in many of these sales being registered, many contract valuers do not get access to the ‘best’ evidence of market movement until late in the valuation program. As suggested by the examples in Table 2 and evidence from contract valuers and managers quoted in section 4.5.2.3 above, component factors are usually proposed and approved in many districts at a time prior to the contract valuer’s full analysis of the market evidence. They may have only analysed two thirds of the sales by mid September when component factors are required. Furthermore, there is a heavy reliance on older sales. As revealed in Table 2, it appears on average that only a third of sales relied upon are transacted within two months of the 1 July base date. While older sales may be relevant and useful in the absence of more recent sales, they need to be adjusted to the base date. That introduces a variable of potential error. A ‘catch 22’ also applies to the adjustment scenario. To adjust properly you need to know the market movement. Market movement is best evidenced from sales close to the base date. In the absence of details of such sales, older sales have to be relied upon to predict the market movement – but – they need to be adjusted to the base date to reflect the market movement.

Especially in volatile property markets like those we have experienced over the past few years, clarity about actual market movement increases with distance from the base date because of the greater availability of relevant sales data. The more precise the market movement that can be identified, the greater the likelihood of accurate valuations of benchmark properties, the greater the likelihood of accurate component factors and the greater the likelihood of accurate valuations.

The Valuer General has recently been negotiating with the Office of State Revenue to explore whether access to stamp duty records may provide a timelier source of information about sales transactions close to the base date. A trial run conducted in May 2005 indicated some encouraging results providing approximately 600 additional unconfirmed sales that could be made available to contract valuers to assist pinpointing the market at the base date. While timely access to information about additional sales made close to the 1 July base date will certainly assist the better analysis of the market, the prospective number of additional sales is less than 2% of the total number of analysed sales that LPI annually receives. Accordingly, it is only likely to marginally increase the number of recent sales that can be included in the initial market analysis and will not provide a complete solution to the current timing problem.

The proximity of the base date to the timing of submissions of component factors and proposed values not only affects the capacity to obtain and analyse the most relevant market data, it also affects the amount of time contract valuers have to develop their initial values from the application of proposed factors and to test that data through the application of statistical quality assurance measures and verification exercises. It also significantly limits the time contract valuers have once component factors are approved to verify the resultant values and handcraft where necessary.

The preponderance of the evidence obtained during the course of the investigation suggests that contract valuers consider they have inadequate time in the current schedules to properly perform these fine tuning exercises. Most contract managers agree with them.

The sensible way to resolve both of these problems is to move the base date back at least three months but to only modify slightly the due dates for the submission of the main contract deliverables.

5.3 Inadequate time and resources for contract managers to quality assure proposed factors and values

District valuers have two principal duties –they act as contract managers usually for a number of valuation districts and they investigate and make recommendations on objections. While theoretically the contract management process is a continual one throughout each year, their substantive quality assurance tasks are concentrated into relatively short time periods. The two most critical tasks are their review of proposed component factors when they receive the Component Valuation Reports from contractors usually in mid October and their review of the proposed values usually received in late October.

Many districts have high numbers of components and most district valuers are responsible for oversighting numerous districts. To sight check and review the report for every component in every Component Valuation Report for multiple districts, to conduct an in-depth audit check of at least 5% of them and to provide feedback and make appropriate inquiries of contractors about any perceived issues is an onerous task in a short time frame. The fact that they manage to audit approximately 36% of component reports on average is admirable in the circumstances.

During his evidence, the Valuer General foreshadowed some suggested process improvements one of which was to re-orient contract managers away from monitoring process towards a focus on valuation outcomes. One of the changes being introduced for the 2005 valuation program is to remove the obligation of contract valuers to provide the Component Valuation Report and consequently the requirement for contract managers to audit these reports and approve the proposed component factors. This is to be balanced by a greater emphasis on contract managers monitoring sales analysis including joint field tours with contract valuers to provide an overview of the analysis procedures and value levels, the submission of regular statistical reports by contract valuers with explanations of how any conflicts indicated in the valuation process have been resolved, and the more systematic review of market data using new analysis tools linked to Valnet data.

The information that the Component Valuation Report comprises will still be obtained in the Market Data File that contract valuers are required to provide. This information is important because it is the principal means by which valuations are tracked back to relevant sales and are relied upon to deal with objections. It will be important to review the impact of this change as it was clear from our audit of district files that the work of contract managers reviewing Component Valuation Reports and providing feedback to contract valuers definitely enhanced the quality of the analysis that led to benchmark valuations and the production of proposed component factors for many districts in previous years.

The compression of the time between submission of the proposed values and acceptance of those values is however the most significant timing problem. Most contract managers spend what is normally only a few days running serial data integrity checks but have little or no time to assess the actual quality of the proposed values. Quality statistical measures are provided at the same time and if they indicate potential problems through non-conformance with the prescribed standards, there is literally no time to do anything about it. At best, contract managers require contract valuers to explain the non-conformance and to attend to it during the next valuation program. This is unsatisfactory. In practice it ignores potential inaccuracies in the values and defers their resolution to the next year, without there being any guarantee that this will in fact happen.

Again, moving the base date back three months and allowing more time for contract managers to quality assure the proposed values and time for contract valuers to resolve any identified problems would be a desirable reform.

5.4 Inadequate observance of standards for component composition and benchmark selection

The effectiveness of the component method of mass valuation is dependent upon the integrity of its key building blocks –component composition and benchmark selection. These currently are the responsibility of contract valuers. While they necessarily rely a good deal upon the professional judgement of valuers in their establishment, from a quality assurance perspective there are some quantitative indicators that assist in assessing how well actual components and benchmarks meet some of the underlying assumptions.

As set out in section 4.6.1 above, the key assumption relating to component composition is that components are made up of homogenous properties that move in value in a uniform way. Surprisingly, there are no statistical measures currently applied to test the basic assumption of homogeneity of value change at the component level⁷⁷. There are usually not enough sales at the component level to reliably measure value change using the current suite of statistical measures.

In the absence of such measures, the next best indicator is the homogeneity of values in a component as properties with values at the extremes, particularly the highly valued properties, have generally been found to more likely experience atypical value movements. While wide ranges of values in a component may not necessarily indicate disparate movements in value, the risk of inaccuracies in values from the application of component factors is higher in such components particularly those where the component factor is derived from the valuation of only one benchmark.

As detailed in Table 5 and section 4.6.1.2 generally, there is a relatively high number of components across the state that have high ranges of variation in values and do not meet the currently prescribed standard of having a QRP below 50%. In the absence of sound qualitative or alternative quantitative measures of component homogeneity, there is insufficient available evidence to assure the Valuer General that these non-conforming components are indeed homogenous.

This is particularly of concern in relation to residential components where generally there is less handcrafting and greater application of component factors.

One would expect that contract valuers be asked to review each non-conforming QRP and acquit them to the contract manager to ensure that they are reviewed. Some will be easily explainable as the example of the open space

component MA in Taree mentioned in the quote from the contract valuer on page 37 illustrates, while others will require more detailed assessment.

Logically, components with wider ranges of values should be the components where you would expect to find multiple benchmarks. The establishment of additional benchmarks and the use of sub-component factors in those components with high QRP values may be an acceptable strategy for providing the necessary assurance that potential lack of homogeneity is adequately provided for.

As set out in section 4.6.2, the other critical foundation stone of the component method of mass valuation is having representative benchmarks. Again from a quality assurance perspective, the risk of benchmarks not being representative increases the further they are from the middle range of values within a component. As set out in Table 7 there is an extremely high rate of non-compliance with the prescribed standard for benchmark properties being within +/- 5% of the median value. A sample of 90 valuation districts indicated that 61% of residential components used benchmarks that did not meet the current standard prescribed by the Valuer General and non-compliance was even higher in other zones. While there is some agreement that this standard may be too prescriptive, the number of benchmarks that are not even within the interquartile range is still unreasonably high. Nearly a third of residential components use benchmarks that are not within the interquartile range. While there may not necessarily be a better benchmark for many of these, there needs to be a critical assessment of all of these non-conforming benchmarks and a proper acquittance of them through either an explanation of why their continued use is satisfactory or their progressive replacement or the use of additional conforming benchmarks.

5.5 Inadequate monitoring of component and benchmark reviews

Maintaining the integrity of the key building blocks of the component system of mass valuation requires continual review and fine tuning of components and benchmarks due to changes that occur over time in the value relationship between properties within components. While the responsibility for this lies with contract valuers who maintain the records of benchmark and component changes, from a quality assurance perspective one would expect that contract managers would take a keen interest in ensuring this occurs and that the outcomes of such reviews are satisfactory.

The *Procedure Manual for Contract Valuers* requires every component to be scrutinised during the term of each contract to identify properties that are outliers that should be moved to other components. This current procedure also requires contract managers to approve changes to components.

Our review of a sample of district files revealed little evidence of any detailed monitoring or reporting of such contractor reviews. There appears to be no records kept by contract managers of the progressive review of components over different valuation years. It is therefore impossible to verify whether contractors have complied with this requirement of the procedures manual or not, let alone whether the outcomes of any reviews conducted are satisfactory.

Apart from occasional simple comments in correspondence to contractors following examination of component data tables saying some of the results are not in compliance with the standards set out in the procedures manual and asking that they be addressed in the next valuation program, we came across no evidence of any detailed analysis of the extent of non-compliance with quantitative quality measures relating to component composition and benchmark selection either at a contract level or the wider system level.

Evidence of a number of witnesses interviewed during the investigation suggested that contract valuers have little financial incentive to invest meaningful time in doing infrastructure work like reviewing components, establishing more representative benchmarks, or even handcrafting during the valuation program, so that progressively the reliability of the component system of mass valuation is being eroded. Even the Chief Valuer confirmed "there's an element of truth in that".

It is therefore important that contract managers are more proactive in ensuring there is adequate attention paid to these tasks. There should be detailed action plans drawn up with each contractor that prioritise particular areas and particular benchmark properties for review based on a thorough analysis of the quantitative data and any other relevant information that is available. This should then be properly monitored. The lack of documented corporate knowledge in LPI about component and benchmark reviews also means at changeovers from one contract manager to another, or from one contractor to another, it is extremely difficult for them to assess the 'health' of a district in terms of how recent and how extensive various components have been reviewed and what continuing or potential problems there may be.

5.6 Inadequate monitoring of valuation outcomes

Apart from obvious anomalies picked up through data integrity checks, up until the 2003 program there appeared to be little if any quantitative quality analysis of the proposed values put forward by contract valuers prior to their acceptance and inclusion in the Register of Land Values. Since 2003 some quality statistical measures have been introduced to assist in the assessment of the level of accuracy and uniformity of the values proposed. However, as the evidence canvassed in section 4.6.7.8 illustrates, this information is produced too late in the valuation program for any constructive action to be taken if the measures do not meet the Valuer General's standards. In most instances, non-conforming statistics were supplied without any explanation and even where contract managers subsequently sort such clarifying information, the responses provided were far from comprehensive and generally did not provide sufficient information to properly assure contract managers that there were not genuine anomalies that required rectification.

Even monitoring by the simplest statistical indicator of valuation accuracy, the percentage error between proposed values and adjusted land values, by way of the Variation by Sales Report is under utilised. In the sample of district files we audited, we found no evidence of this version of the report among records of the data integrity checks undertaken let alone any evidence of contract managers questioning contract valuers about high rates of variation. It appears more can and should be done to identify anomalous values before they are accepted.

There appears to have been little or no attempt to systematically assess the level of compliance with the quality statistical measures or to assess the sufficiency of action taken in non-complying districts at a system level.

Consequently, there is an over reliance upon the objection system to correct any inaccuracies in the values produced by the component method. Even here, there does not appear to be any systematic analysis undertaken at a system level to review objection trends. At most it is left to regional valuers to identify any trends or 'hot spots' as they consider individual objections that come across their desk for determination. While this certainly leads to some instances of re-ascertainment of other properties where objections reveal substantive anomalies, it is inadequate as a quality assurance system to monitor and assess the general standards of accuracy of valuation recommendations across the whole state.

5.7 Inadequate resourcing of the contract management function

Many of the deficiencies identified above are the product of thinly stretched resources. I was impressed with the dedication of many of the contract managers interviewed as part of the investigation but their ability to perform a high quality service is severely limited by the time they have available to perform many of the quality checks they are expected to do. No training in basic contract management skills has been provided to them and even training on key issues such as the use and interpretation of the new statistical measures has only recently been provided. In such circumstances it is not surprising that some inconsistent practices have developed and that the standard of record keeping is generally inadequate. While the current quality assurance framework recognises the need to have a continuous internal audit of contract management practices, the current staffing complement of District Valuers appears inadequate to enable Regional Valuers to be relieved of their own contract management duties to perform this important duty. This needs to be addressed in order to establish greater adherence to the standards for contract management set out in the *Rating and Taxing Valuation Contract Procedures Manual*.

5.8 Poor quality control of objection processing

By 30 June 2005, a little over 50% of the objections lodged against the 2004 land values had been determined. If the current trend continues, it indicates a substantial increase in the proportion of objections allowed.

The Valuer General's actions since commencing in the role have demonstrated his commitment to customers and quality outcomes. He and the Chief Valuer freely admit there is room for improvement in the objection process. Our examination of the Valuer General's claim about embedding the principles of accountability, consistency, independence and transparency in the valuation system shows much work still needs to be done in relation to the objection process.

Proper accountability enhances public confidence in government and helps to ensure that government is properly responsive to the interests of the people. Accountability is primarily achieved through having policies, practices and records that can withstand scrutiny by others.

The most outstanding concern about the accountability of the objection process is the lack of a formalised and standardised objection procedure and documentation. The draft Objection Procedures Manual was only developed in May 2004 and is still not finalised. The fact that it has remained unfinished at a time when LPI has been dealing with a record number of objections and employing contractors is a surprising omission. To some extent, evidence given

to the investigation suggested an attitude that because valuers were professionals with extensive knowledge of rating and taxing valuations, a somewhat specialised field of valuation, they could be relied upon to produce high quality outcomes without recourse to procedure manuals. The investigation clearly demonstrates that this is a problematical attitude and not conducive to accountability or consistency.

To correct this situation the Objection Procedures Manual must be finalised and implemented as soon as possible.

For similar reasons, documentation associated with objection processing needs to be reviewed and standardised. A standard objection worksheet should be introduced and the current objection control sheet should be reviewed to reflect all the steps in the objection process set out in the draft Objections Procedure Manual. The contents of the objection control sheet should demonstrate how a decision was reached and the reasons for the decision. The legible name and position title of the recommending valuer and the final decision-maker should be standard on the objection control form.

The standard paragraphs used in notices of determination to objectors insufficiently account for the reasons for a decision. There is a clear need to review the standard paragraphs and encourage a higher standard of determination correspondence. The objection process on the whole is thorough but often the correspondence that conveys final determinations masks that thoroughness and leaves objectors sceptical of the seriousness with which their objection has been dealt.

While it is not always easy to strike the right balance between providing too much detail and too little detail, and it is not necessary to always deal with every issue objectors raise, over reliance on the current standard paragraphs limits the decision-maker's approach to more fully accounting to the objector for the decision.

In addition the notices of determination the Department of Lands sends to objectors do not identify the decision-maker. This is unhelpful and does not meet the Valuer General's requirement for accountability. This practice should be reviewed.

Consistency requires a standard approach to processes and procedures. A standard approach provides confidence in the reliability and predictability of the system. Without a procedures manual and standardised documentation, the objection system has to rely on the knowledge, goodwill, integrity and discretion of the decision-makers.

A lack of a procedures manual for objections also removes the authority of the process from the Valuer General to line managers in LPI. While I have no reason to doubt the Valuer General's and the Chief Valuer's confidence in the professional skills and integrity of LPI senior valuation staff, from the point of view of objectors, the process must not only be properly managed but be seen to be properly managed by the Valuer General.

Our review of a sample of 29 objection files indicated a general lack of consistency in processing objections. I consider the inconsistencies identified came about as a result of a lack of standardisation. In this regard the Valuer General cannot be completely confident of the outcomes, nor can objectors have confidence in a system without documented procedures to guide decision-making.

I also consider that consistency was impeded by the lack of ongoing systematic analysis of objection trends. The Valuer General's Valuation Management Committee should help develop guidelines and an action plan for the system level review of objection trends and outcomes.

The independence of decision-making is central to how the objection process is perceived. To remove any possible perceptions of constraints on LPI's willingness to assess objections on their merits or re-ascertaining values, the Valuer General and the Chief Valuer should review the Service Level Agreement with LPI to properly reflect LPI's responsibilities.

The large increase in objections in the 2004-2005 valuation program has placed an additional load on LPI's resources and it remains to be seen whether the contracting out of objections processing to independent valuation firms expedites the finalisation of as many objections as the Valuer General and the Chief Valuer anticipated in their evidence. Even if the contract valuers do process a significant number of objections in a quicker timeframe than LPI was able to achieve, the number of regional valuers in LPI would not be able to thoroughly review each objection before making a final decision and the backlog might shift from one aspect of the process to another rather than being cleared up. In these circumstances, the use of district valuers to ensure as many objections are finalised in the 90-day turnaround time is not unreasonable.

It is clear that many people are having difficulty coming to grips with the complexities of land valuation. The heightened interest in property as a means of wealth accumulation and security has driven and in turn been driven by a significant amount of information about property prices and the real estate market available through the media and the Internet. This information has not necessarily clarified land valuation for rating and taxing purposes in the minds of the public.

While the Valuer General has taken commendable steps towards making the objection process more easily accessible and transparent, the investigation has revealed ways the provision of information to objectors can be improved.

Recent changes to the procedure for lodging objections through a more rigorous screening process may disadvantage objectors lacking knowledge and access to resources that would assist them to complete what many see as a time consuming and onerous task. While I have no doubt a major intention behind the introduction of the new, mandatory Valuation Objection Form was to assist objectors, the guidance provided with the objection form is inadequate. I consider the Valuer General should develop some model objections based on the most widely used grounds for objection. These should be accompanied by clearer explanations of the possible grounds of objection and the supporting information required. All this additional information should be attached to Valuation Objection Forms when sent to potential objectors and made available on the Department's web site.

Even though the Valuer General has implemented better access for objectors to sales information through the General Valuation Sales Report and access to individual valuations through the Land's Department website, objectors and potential objectors are still not being given access to essential information to properly assist them. The Chief Valuer agreed that the analysed adjusted land value of sales properties should be included in the General Valuation Sales Report. In this way objectors would be better able to compare their own land value with the land value of sales in their areas and make an informed decision about whether to object to the value or not. This information is held in the Valnet database and is not difficult to access or include in the General Valuation Sales Report. The Chief Valuer agreed this was an improvement that could be made. I consider that the inclusion of the analysed adjusted land value should be made available to objectors as part of the sales reports being provided to objectors and potential objectors.

The investigation also revealed that the most relevant information about sales used to support valuations is not provided to objectors unless they speak directly to a contract manager and ask specifically for it to be provided. I consider the Valuer General should implement a system that ensures objectors and potential objectors inquiring about their valuation are provided with the relevant sales information without having to consult a contract manager. Should the use of a call centre be retained in future valuation programs to deal with initial objection enquiries, a system should be implemented to enable them to access and distribute the appropriate General Valuation Sales Report to satisfy the enquiries information needs.

5.9 Summary conclusion

It is clear that the Valuer General with the assistance of the Chief Valuer has introduced many initiatives to improve the operation and reliability of the mass valuation system in NSW since their respective appointments in late 2003. They are to be commended for the improvements that have already taken place. There is still much that needs to be done. I have found there is currently inadequate adherence to the controls employed by the Valuer General to ensure the accuracy of valuations derived from the component method of mass valuation in NSW and that the provision of information to potential and actual objectors is also inadequate. Such conduct is unreasonable in terms of section 26(1) of the Ombudsman Act. Accordingly I make the following recommendations based on the findings and issues that are canvassed in this report.

6. Recommendations

- 6.1 The Valuer General introduce a structured program of handcrafting and review of component structures to 're-set' the valuation base line in the majority of districts of NSW.

The Valuer General should use the model of the Wollondilly contract and also explore other alternative approaches to achieve this. Variations to key existing valuation services contracts to cater for these additional services should be offered and the requirement for these additional services progressively introduced into new contracts as they become available. Priority should be given to those districts where the statistical measures indicate high levels of non-compliance with the expected standards, where there are high rates of successful objections or where value changes have been most pronounced. At least a third of valuation districts should be targeted to be completely re-assessed within the next five years.

- 6.2 The Minister initiate action to seek Cabinet endorsement to amend section 14B of the Valuation of Land Act to provide for land to be valued for the purposes of a general valuation at 1 March in the valuing year in which the valuation takes place.
- 6.3 Subject to a change in the valuation base date, the schedule for the production of proposed values by contract valuers be amended to provide a reasonable time buffer for contract managers to perform an expanded range of data integrity and other quality checks to better ensure a high level of accuracy in values prior to their adoption and entry into the Register of Land Values.
- 6.4 Investigate the means by which contract valuers can be required to provide statistical measures prior to the production of proposed values so that any necessary remedial action can be fully explored in relation to non-conforming measures prior to the uploading of values into the Valnet system.
- 6.5 Develop a quality control checklist detailing the full range of data integrity and statistical tests that contract managers be required to run before accepting proposed values that requires contract managers to attest to each test meeting the Valuer General's standards or where they do not meet such standards, attest to the receipt of documented and satisfactory explanations.
- 6.6 Develop other statistical measures and reports to identify unacceptable variations in proposed values.
- 6.7 At the completion of each valuation program and based on a review of compliance with the applicable quantitative component composition and benchmark standards and any other relevant information, contract managers in consultation with contract valuers should draw up a prioritised and detailed action plan for the review of non-conforming components and benchmarks and closely monitor such reviews ensuring that there is an acceptable and recorded acquittance of each non-conforming entity prior to the commencement of the following valuation program. Priority should be given to replacing those benchmarks lying significantly distant from the median value in components with low degrees of handcrafting.
- 6.8 Require contract managers each year to conduct an analysis of and report upon the improvements made in each district in terms of compliance with statistical measures, the effects of changes made to components and benchmarks and general compliance by contractors with their contractual obligations.
- 6.9 Develop a system level overview analysis of key statistical results across districts that is able to track progress in compliance with standards and identify trends.
- 6.10 The Valuer General publish in his annual report performance information on contract valuer compliance with key quantitative standards against base line benchmarks.
- 6.11 The Department seek a budgetary enhancement to employ sufficient additional District Valuers to properly manage valuation services contracts and enable regular contract management auditing.
- 6.12 That a methodology be developed for the Regional Valuer contract management audits referred to in section 1.3.6 of the *Rating & Taxing Valuation Contract Management Procedures Manual*.
- 6.13 Ensure all contract managers receive training on principles of contract management and record keeping relevant to the management of valuation services contracts
- 6.14 That a needs analysis be undertaken towards the end of the 2005 valuation program to identify further training needs of contract managers and contract valuers in the use and interpretation of key statistical measures and that further statistical training be provided based on the findings of that analysis.
- 6.15 That application of a uniform methodology for the valuation of improvements for purposes of undertaking sales analyses be encouraged by the incorporation of suitable guidance in a revised *Procedure Manual for Contract Valuers*.
- 6.16 That application of a uniform methodology for the adjustment of sales for time be encouraged by the incorporation of suitable guidance in a revised *Procedure Manual for Contract Valuers*.

- 6.17 That the *Procedure Manual for Contract Valuers* require contract valuers to provide explanations of the basis of their adjustment methodology.
- 6.18 That the directions contained in the *Procedure Manual for Contract Valuers* for the sales to be used in calculating the quality statistical measures be amended to exclude any sale where the assigned value was not produced by the application of a component or sub-component factor.
- 6.19 That the *Procedure Manual for Contract Valuers* be amended to provide that component factors should not be rounded down.
- 6.20 That the component check form be re-designed to take account of the observations set out in section 4.5.2.8.
- 6.21 That LPI consider the need for a report to update contract managers on a monthly basis of the total number of sales in their districts to assist their assessments of the sufficiency of sales analyses by contract valuers.
- 6.22 That consideration be given to the usefulness of including in Valnet a field that would indicate whether a value was completely handcrafted or was a factorised value that was verified.
- 6.23 That the Valuer General provides suitable guidance notes for potential objectors on the type of information that would support 'model' objections.
- 6.24 That relevant sales schedules showing adjusted analysed land values that were relied upon to make or support valuations be made available to potential objectors as a matter of course.
- 6.25 That the Valuer General include in his annual report statistics about the number of objections and appeals processed and their disposition.
- 6.26 That a flag be incorporated into Valnet to identify whether a later valuation has been issued once a value amended on objection is entered.
- 6.27 That the objections procedure manual be amended to require assessment of any later issued valuation as part of the standard objection determination.
- 6.28 That the objection procedure manual be amended to require assessing officers to consider whether any adjacent values need to be re-ascertained if an objection is allowed.
- 6.29 That a standard objection worksheet be developed that more clearly provides for the documenting of reasons for objection determinations.
- 6.30 That the standard of objection determination correspondence be increased including the review and reformulation of the use of standard paragraphs.
- 6.31 That the delegated decision maker be identified in objection determinations.
- 6.32 That the objection procedures manual be finalised as soon as possible.
- 6.33 That the Valuer General review the Service Level Agreement with LPI with a view to removing (a) any KPI target that relates primarily to the performance of contract valuers rather than LPI, and (b) any KPI target relating to re-ascertainment rates or allowable objections that could be perceived to restrain LPI from properly using its professional discretion in performing its duties in relation to these functions.
- 6.34 That the standard service obligations in the model valuation services contract be amended to include an obligation to keep under review and maintain appropriate components and benchmarks to ensure the integrity of values produced using the methodology.
- 6.35 That the Joint Committee on the Office of the Valuer General conducts a cost/benefit review of amending the Valuation of Land Act to provide for the issue of annual valuation notices.
- 6.36 That the Joint Committee on the Office of the Valuer General monitor compliance with the key quality statistical standards of the Valuer General as part of its annual program.
- 6.37 That the Joint Committee on the Office of the Valuer General review the results and implications of the 2005 check valuations project as part of their general overview of the methodologies employed for the purpose of conducting valuations under the Valuation of Land Act.
- 6.38 That the NSW Treasury examines the desirability of basing land tax assessments on a rolling 3 or 5 year average land value rather than annual land valuations.



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Endnotes

- ¹ As the majority of valuers continue to refer to Property Valuation Services as the State Valuation Office, the terms are used interchangeably in this report.
- ² The Hon. Kim Yeardon, New South Wales Parliamentary Debates (NSWPD), Legislative Assembly, 13 November 1996.
- ³ The Hon. J W Shaw, New South Wales Parliamentary Debates (NSWPD), Legislative Council, 4 December 1996.
- ⁴ Department of Public Works and Services, *Call for Tenders for Provision of Valuation Services for Government Taxing Rating for the Valuer-General's Department*, 1 May 1998 to 30 April 2001, p27.
- ⁵ NSW Legislative Council, General Purpose Standing Committee No 1, *Report on the Inquiry into Changes in Land Tax in New South Wales*. Report No 3, July 1988, at 70.; NSW Government, *Report of Inquiry into Operation of Valuation of Land Act*, Julie Walton, October 1999 at 9.
- ⁶ Walton, *ibid*, p7.
- ⁷ Associate Professor John MacFarlane, *Issues Relating to the NSW Mass Valuation System: Consultants Report No 1*, March 2002.
- ⁸ Valnet is the name of the computer database and suite of programs used to store and interrogate all land values and associated valuation information.
- ⁹ Recommendation 6.2 was accepted in principal subject to the agreement of the Minister and the majority of stakeholder groups.
- ¹⁰ The sales comparison approach is not the only valuation method but the one most commonly used, particularly for valuing residential properties. It considers sales of similar or substitute properties and related market data and establishes a value estimate by processes involving comparison. A property being valued is generally compared with sales of similar properties that have been transacted in the open market. Listings and offerings may also be considered.
- ¹¹ Walton, *op. cit* p81.
- ¹² Source: Reserve Bank of Australia inflation calculator, <http://www.rba.gov.au/calculator/calc.go>
- ¹³ OSR paid \$11,937,000 to the Department of Lands for land information and valuation services required to administer the Land Tax Management Act in 2003-2004 – source Office of State Revenue, *Annual Report 2003-2004*, financial statements. According to the Department of Lands' *Annual Report 2003/2004*, p34 OSR was supplied with over 2.3 million values for land tax purposes and a further 57650 supplementary notices of valuation following changes to properties or the creation of new lots. This is equivalent to \$5.06 per valuation for the total number of valuations or \$5.19 per valuation for the initial 2.3 million valuations.
- ¹⁴ Data source: www.lands.nsw.gov.au/Records/Valuation/landvalcontractors.htm, accessed 16 August 2005.
- ¹⁵ Australian Property Institute & New Zealand Property Institute, *Professional Practice 2004*.
- ¹⁶ The term "handcrafted valuations" has been in common in usage for a number of years without a clear definition and consequently has come to mean different things to different people leading to inconsistencies in its use. The term was further refined in the contract for valuation services for the Wollondilly area issued for 1 May 2004 to 30 April 2007 (see 6.6.8 below) as "a valuation made using the methodology and which has been individually determined or verified", which was the definition incorporated in the draft version 4.1 of the Procedures Manual issued with the September 2004 tender and version 5.0 issued on 8 July 2005 which will apply to the 2005 valuation program.
- ¹⁷ Department of Lands, *Procedure Manual for Contract Valuers*, V3.1 p1.
- ¹⁸ Criteria taken from Australian Audit Office, *Contract Management Better Practice Guide*, February 2001, p31
- ¹⁹ *ibid* p36
- ²⁰ The Chief Valuer suggested compliance with contract management procedures should be included in the Department of Land's general internal audit program last year. Terms of reference for such an audit to be conducted by Deloitte Touche Tohmatsu as part of its Department of Lands internal audit services for 2004/05 were finally drawn up in June 2005 and were scheduled to commence on 20 June 2005. A draft report was being finalised at the time of writing this report.
- ²¹ Specific contract management training relating to rating and taxing valuation contracts was provided in 1998 to the original 19 staff who had contract management responsibilities at that time. Other senior valuers have attended contract management training workshops either while formerly employed in the Department of Information Technology and Management or in recent years in LPI. A number of senior staff since 2004 have also been involved in external leadership and management development courses.
- ²² Up to and including the 2003 valuation program, a further report known as the Component Factor Report had also been required no later than the second week of September. This was a list of proposed component factors that was used to inform the Valuer General of the likely movement in values of all land classes although not all sales would have been analysed at that time. It was used to enable a preliminary estimate to be made of the movement in land values for the annual determination of the land tax threshold required during September. The removal of the threshold in the April 2004 mini-budget removed the need for the report and it was eliminated as a requirement in version 3.1 of the *Procedures Manual for Contract Valuers* used for the 2004 valuation program.
- ²³ *Maurici v Chief Commissioner of State Revenue* [2003] HCA 8 (13 February 2003)
- ²⁴ International Association of Assessing Officers, *Mass Appraisal of Real Property*, Chicago 1999 p263
- ²⁵ For the 2003 valuation program, the requirement was to randomly check at least 10% of all component reports. This was reduced to 5% in the version used for the 2004 valuation program and remains at that level in the latest version that will be utilised for the 2005 program.
- ²⁶ Figures marked with asterisk were identified from critical narrative comments about component reports rather than from the prescribed component checklist. This means more components reports could have actually been checked by the relevant contract manager and found to be satisfactory.
- ²⁷ This requirement has been dropped in version 4.0 that will apply to the 2005 valuation program.
- ²⁸ Not all districts have all zones
- ²⁹ In fact, the standard was suggested by the consultancy work of Professor MacFarlane on the 2001 valuation program of results in 10 metropolitan districts and was confined to his examination of residential components in those districts. The QRP statistic is calculated on the basis of block value only. Professor MacFarlane has subsequently suggested that in components where the basis of valuation is not the direct comparison of block value (for example, comparison of \$/hectare or \$/m2 in some rural areas), it may be that the QRP statistic should be based on the unit used as the basis of valuation.
- ³⁰ The median is a measure of central tendency and is best described as the positional average. It is not affected by the size of any extreme values because it is based on the rank of the value when they are arranged in the order of magnitude.
- ³¹ The zoning codes used are : A- residential; B- commercial; I- industrial; N- national parks; O- open space; P- scenic protection; R- non-urban; S-special uses; and Z – undetermined or zoning being changed.
- ³² MacFarlane, John, *Issues Relating to the NSW Mass Valuation System –Consultant's Report No. 2*, Property Research Centre, University of Western Sydney, September 2002.
- ³³ The contract manager at this point checked to see why he had not picked the discrepancy up and found that it was a component that he had not audited.
- ³⁴ Even if all properties in a component are handcrafted, the Valnet software requires a component factor to be calculated and so contract valuers still value a representative benchmark property and derive a component factor for each and every component.
- ³⁵ For the sake of the demonstration, it is assumed the true value of the median property increases in value by 14% each year as it did in 2004.
- ³⁶ Calculated by dividing the new 'true value' by the previous assigned value.

- ³⁷ In fact the stated range for the revised MVP was not 90-100%. In the 2003 version of the *Procedure Manual for Contract Valuers* the accepted measure for the MVP was 85-110%. The Valuer General subsequently revised this for the 2004 program to be 85-100% to discourage any valuation being above the market level. This was incorporated into version 3.1 of the procedures manual that was released on 6 July 2004.
- ³⁸ The nature of mass valuations in any system is such that the achievement of 100% accuracy for all valuations is an ideal rather than a reality. More generally, it appears to be accepted professional practice that where there is any doubt in the land value to be applied, the doubt should always be resolved in favour of the rate or tax payer, that is, an implicit aim of the system is to avoid over-valuation so there will always be a bias towards under-valuation.
- ³⁹ David Singer, letter to Ombudsman 11 June 2004.
- ⁴⁰ For example: "Valuation is not a science; it is an art, and an instinctive 'feel' for the market of an experienced valuer is not something which can be ignored" – *Craneheath Securities Ltd v York Montague Ltd* [1996] 1 EGLR 126; "Valuation is not an exact science; it involves questions of judgement on which experts may differ without forfeiting their claim to professional competence" – *Zubaida v Hardgreaves* [1995] 1 EGLR 127.
- ⁴¹ Crosby, Neil, Valuation accuracy, variation and bias in the context of standards and expectations, *Journal of Property Investment & Finance*, Vol 18, No 2, 2000, pp130-161.
- ⁴² *The Variance in Valuations: Interim Report 1997*, Drivers Jonas/Investment Property Databank, London
- ⁴³ Commercial property market prices and valuations: analysing the correspondence, *Journal of Property Research*, Vol 12 pp181-202
- ⁴⁴ The accuracy of valuation –expectation and reality, unpublished paper University of Reading.
- ⁴⁵ Valuation accuracy –an Australian perspective, paper to 4th Pacific Rim Real Estate Conference, Perth January 1998
- ⁴⁶ The accuracy of commercial property valuations, paper to 4th Pacific Rim Real Estate Conference, Perth January 1998
- ⁴⁷ Hutchinson N, McGregor B, Nanthakumaran N, Adair A & McGreal S (1996) , Variations in Capital Valuations of UK Commercial Property, Research Report, The Royal Institute of Chartered Surveyors, London
- ⁴⁸ Cosby, op cit. p149.
- ⁴⁹ Crosby, N, Kincaid D, Murdoch J & Lavers A, Expert Valuation Witnesses in Australia and the UK, paper to 5th Pacif Rim Real Estate Conference, Adelaide, January 2001.
- ⁵⁰ For example, a standard text on mass appraisal –Robert Gloudemans *Mass Appraisal of Real Property*, International Association of Assessing Officers, Chicago 1999-suggests CODs for single family residences should generally be below 15 with newer and fairly homogenous areas 10 or less, for incoming producing properties be 20 or less and in larger urban jurisdictions 15 or less (p246).
- ⁵¹ MacFarlane J, *Statistical Measures for Mass Valuation*, Office of the Valuer General & College of Law & Business, University of Western Sydney, June 2005.
- ⁵² MacFarlane *ibid* p26-27.
- ⁵³ 10 of the 45 districts with an MVP within the 85-100% standard were only within 3% of meeting that standard.
- ⁵⁴ It would be unnecessary to exclude sales where the assigned value had been handcrafted merely by verification but was the same as the component factored value. Identification of such properties would however require two different handcrafting flags – one denoting an individualised valuation, the other denoting a value that had been verified but was derived by application of the component factor.
- ⁵⁵ During the course of the investigation, the Valuer General attempted to address this issue by engaging Professor MacFarlane to run a series of four one day workshops on statistical measures for mass valuation for contract valuers and contract managers in June 2005.
- ⁵⁶ International Association of Assessing Officers, *op cit.* p.27
- ⁵⁷ John Wilson, Regional Valuer-Southern, memo to Chief Valuer 27 April 2005.
- ⁵⁸ Op.cit, p. 39.
- ⁵⁹ The figures in the 'Received' and 'Allowed' columns for previous years were unavailable or unreliable because of changes in the recording of objection data following a major reconfiguration of the Valnet system in early 2001, the use of separate Registers in earlier years, and the recording of only changes to valuations following successful objections.
- ⁶⁰ The Land and Environment Court advised the increase in appeals in 1998 and 1999 related to large increases in land values and the commencement of the *Premium Property Tax Act 1998*. A large number of the appeals lodged in those years related to valuations in Hunters Hill, Woollahra and Waverley. The number of objections in the districts with properties affected by that Act also was significantly higher in those years.
- ⁶¹ Gilkes S & Shaw A, *The Systems for Objections to Land Values – Funding proposal for NSW Treasury*, 15 November 2004, p9.
- ⁶² *Statute Law (Miscellaneous Provisions) Act (No 2) 2004*; now section 33 of the *Valuation of Land Act 1916*.
- ⁶³ As at 30 June 2005, re-ascertained values as a percentage of total valuations issued equated to exactly 0.25%. It is expected that this percentage may marginally increase in the next few months but not significantly as the majority of mass re-ascertainments have already been completed.
- ⁶⁴ A Shaw & S Gilkes, *The system for objections to land values options paper*, version 1, 7 December 2004.
- ⁶⁵ Letter dated 9 May 2005.
- ⁶⁶ Some simple objections such as those based on mis-descriptions of the land may not necessitate a site inspection, in which case the objection is processed by way of a desktop review. The Valuer General estimated that approximately 15% of objections could be handled in this manner. Source: Joint Committee on the Office of the Valuer General, *Report of the Second Meeting with the Valuer General*, July 2005, page 53 of transcript of proceedings 19 May 2005.
- ⁶⁷ The files were a mixture of randomly chosen files and targeted files based on complaints received by the Ombudsman.
- ⁶⁸ Dated 9 May 2005 enclosing reports of the *Rating and Taxing Reporting Scoping Review Project Plan, Management Valuation Committee Report*.
- ⁶⁹ For instance, currently Valnet does not record whether a particular valuation was handcrafted.
- ⁷⁰ Memorandum from Valuer-General to Chief Valuer dated 28 July 2004.
- ⁷¹ Letter to the Ombudsman dated 24 March 2005.
- ⁷² Lake Macquarie Ratepayers Action Group, letter to Ombudsman 28 June 2005.
- ⁷³ International Association of Assessing Officers, *op cit* p27
- ⁷⁴ Total rate revenue for 2003/2004 – source: *Comparative Information on NSW Local Government Councils 2003/2004*, NSW Department of Local Government, 2005.
- ⁷⁵ Total land tax assessed for 2004 tax year –source: Office of State Revenue direct contact.
- ⁷⁶ It appears the 'old' Valuer General's Department was a significant training ground for many valuation professionals.
- ⁷⁷ The current Valuer General clearly recognises the need to implement better statistical quality assurance measures to increase valuation accuracy and reliability and has been negotiating for some time with the University of Western Sydney to establish a co-operative program to undertake further research into this area. Unfortunately, an Australian wide search has been unsuccessful to date in attracting someone to undertake a PhD that was to be the basis of the research effort. Negotiations are currently underway for the alternative provision of this technical assistance.



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