Toitū Te Whenua
Land Information
New Zealand

Rating Valuations Regulatory System Assessment Summary

1 October 2021

Te Kāwanatanga o Aotearoa
New Zealand Government

Contents

Regulatory stewardship

1. Toitū Te Whenua Land Information New Zealand (LINZ) has a regulatory stewardship programme to enable the Chief Executive to discharge her responsibilities as steward of LINZ's regulatory systems.

2. A key part of the programme is the periodic assessment of LINZ's regulatory systems. These are designed to provide a snapshot of system performance and identify issues of concern. They do not analyse alternate system designs or test the merits of the system's objectives.

3. This document is a summary of the assessment of the Rating Valuations regulatory system undertaken during 2020.

4. The assessment was led by the Director Regulatory Stewardship and is based on a review of internal policies, the Valuer-General's audit reports, and interviews with three Valuation Service Providers, a range of Territorial Authorities, the Valuer-General and his staff, and other stakeholders with good knowledge of the current Rating Valuations system[1].

What is the Rating Valuations Regulatory System?

Purpose

5. The objective of the Rating Valuations regulatory system is to produce rating valuations that are nationally consistent, impartial, independent, and equitable, so territorial authorities (TAs) can implement their rating policies. Rating Valuations are required to be a reasonable proxy for the market value of the rating unit at the time of revaluation.

6. New Zealand's TAs rely on rates to generate over $5.8 billion (approximately 59 percent of their total operating income) to deliver a range of services to their communities. Rating valuations do not directly determine rates but are the values TAs use when implementing their rating policies.

Legislation and related instruments

Legislation

7. The primary piece of legislation in the Rating Valuations system is the **Rating Valuations Act 1998 (RVA)**. The RVA:

    a) provides for the Valuer General (VG) to be a statutory officer within LINZ

[1] Appendix provides more detail on the assessment methodology.

b) introduces contestability to the rating valuations market by assigning to the VG a regulatory rather than an operational role in the preparation of District Valuation Rolls (DVRs)[2]

c) repeals the Valuation of Land Act 1951 and generally restates the law relating to the valuation of land for rating purposes.

8. The RVA also defines a rating unit against which rates are payable under the **Local Government (Rating) Act 2002**.

9. The **Valuers Act 1948** sets the rules on who can undertake property valuations in New Zealand and how registered valuers should operate.

Other Instruments and guidelines

10. The other instruments and guidelines in the system are:

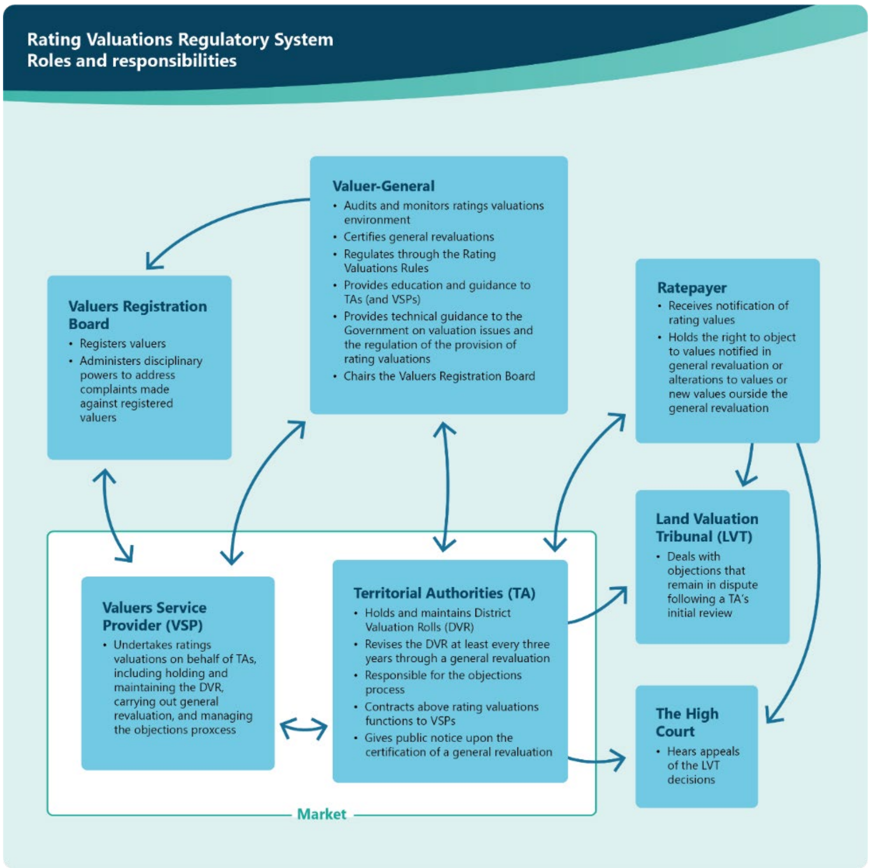
- The **Rating Valuations Rules 2008** are issued by the VG under the RVA. The rules prescribe the requirements that TAs must meet when revaluing their DVR and recording and updating rating information in the DVR and supporting registers.
- The **Rating Valuations Regulations 1998** set out the procedures that property owners can take to object to their rating valuation when the TA issues a revaluation notice.
- The **Rating Valuations (Local Authority Charges) Regulations 1999** provide for the VG to charge TAs for the costs to set standards and undertake DVR audits.
- The **Rating Revaluations Handbook** issued by the VG helps TAs and their Valuation Service Providers provide assurance to the VG that their revaluation meets the minimum compliance standards for certification.
- The **Mangatu Guidance 2019** issued by the VG provides guidance on the rating valuation of Māori Freehold Land.

Roles and responsibilities in the system

11. Figure 1 shows the key actors in the Rating Valuations regulatory system, their responsibilities and how they interface with each other.

[2] The operational role in preparing DVRs is usually performed by Valuation Service Providers (VSPs) providing valuation services to TAs under contractual arrangements.

Figure 1 – Roles and Responsibilities in the Rating Valuations Regulatory System



Valuer-General

12. The VG, who is an employee of LINZ, exercises a range of regulatory functions under the RVA in the interest of ensuring a nationally consistent, impartial, independent, and equitable Rating Valuations system. The VG's functions are to:

- Set minimum quality standards for the maintenance and revision of District Valuation Rolls.
- Monitor and audit TAs and their contracted VSPs for compliance with the Rules.
- Certify that general revaluations meet the minimum standards in the Rules so TAs can use new values to set rates.
- Provide technical advice to the Government on valuation issues and on the regulation of the provision of rating valuations.

13. The VG has a small office (the Office of the Valuer-General, OVG) that includes a Deputy Valuer-General and two other staff who support the VG's regulatory work.

Territorial Authorities

14. TAs are required to prepare and maintain their DVR to the standards set by the VG in the Rating Valuations Rules. They are required to update their DVR by 30 June each year to reflect any value changes to rating units as a result of new building work, land subdivisions or new values from valuations that can be requested by owners/ratepayers at any time under s16 of the RVA.

15. At least every three years, TAs must revalue their DVR. They can undertake valuation services themselves or contract a Valuation Service Provider (VSP) to provide valuation services to them. They also have the discretion to determine the basis on which they rate (capital value, land value or annual value[3] as defined by s2 of the RVA).

Valuation Service Providers

16. VSPs[4] are organisations that offer revaluation services to TAs (and may also provide private valuation services). VSPs are contracted by TAs to undertake revaluation work on the DVR, and they may also hold or store data, maintain the DVR and manage the objections process on behalf of TAs. Rating valuation services must be carried out by a registered valuer or by someone approved under the Rules.

Owners/Ratepayers

17. Owners/ratepayers have a statutory right to object to a valuation of their property under part four of the RVA. When objecting to a notified value, owners must demonstrate that the value is incorrect. This can be through providing their own evidence or getting an independent valuation.

Land Valuation Tribunal

18. The Land Valuation Tribunal (LVT) deals with objections relating to rating valuations that are still in dispute following the TA's initial review. There are six regional tribunals; each tribunal is made up of a District Court Judge and up to two registered valuers.

Valuers Registration Board

19. The Valuers Registration Board (VRB) is an independent statutory board established under the Valuers Act 1948. It is responsible for registering valuers and administering

[3] Annual value is the greater of the rent at which the unit would let from year to year, reduced by 20% in the case of houses, buildings, and other perishable property; and 10% in the case of land and other hereditaments: or 5% of the capital value of the fee simple of the unit

[4] There are three VSPs currently operating in New Zealand: QV, Opteon and Lewis Wright. QV (a State-Owned Enterprise) currently holds most of the rating valuation contracts across the 67 TAs.

disciplinary powers to address complaints made against registered valuers. Members are appointed by the Minister for Land Information for a period of three years. The VRB is chaired by the VG.

How the system works

20. Under the Local Government (Rating) Act 2002, TAs set, assess, and collect rates to fund local government activities. Rates must be set in part based on the rateable values in the DVR.[5] Rating valuations are therefore a key part of the infrastructure underpinning local government financing.

21. The Rating Valuations Act 1998 (RVA) requires TAs to maintain their DVR and update it at least every three years by revaluing every rating unit within their district (general revaluations). Almost all TAs[6] contract a VSP to undertake their revaluation of the DVR and ongoing Roll Maintenance work.

22. VSPs use two main mass appraisal methods to revalue a DVR:

    - Hedonic method – property values are generated based on the market movement of a range of characteristics related to that property.
    - Indexation – values are based on previous values adjusted for market movements.

23. Rating revaluations are required to meet the minimum standards prescribed in the Rules. Before a revaluation of the DVR can be implemented (old values overwritten by new values) by the TA, the VG must certify that the revaluation meets the minimum standards prescribed in the Rules. If the revaluation does not meet minimum standards, the VG must notify the TA of the reason(s) why and specify areas where the revaluation needs improvement. When those improvements have been made, the revaluation can be resubmitted to the VG for certification.

24. When a revaluation is certified that it meets the minimum standards, the TA must notify owners/ratepayers that the revalued DVR is open for inspection. Property owners and ratepayers have 30 working days to object to a notified rateable value but have the responsibility to demonstrate that the TA's values are incorrect. The TA (normally through their VSP) then reviews the objection and if they are satisfied that the notified value is wrong, that value is changed in the DVR.

25. If a property owner or ratepayer is not satisfied with the TA's review decision, they can ask for their objection be heard by a Land Valuation Tribunal, which makes a decision regarding the appropriate rating values, based on the evidence submitted.

[5] DVRs are not currently centrally maintained but are subject to the Rating Valuations regulatory framework.

[6] Auckland Council have an in-house valuation team that conducts rating valuations for parts of the Auckland DVR and provides QA and oversight of external VSPs.

Land Valuation Tribunal decisions can be appealed to the High Court and from there to the Court of Appeal, who are the final appeals court for rating valuation matters.

26. In the event that a revaluation is not certified by 30 June the following year, TAs would not legally be able to use their old values nor any uncertified new values to strike rates. This would jeopardise a TA's ability to raise a large part of their revenue.

How is the Rating Valuations Regulatory System Performing?

The system currently fulfils its purpose

27. The Rating Valuations regulatory system delivers certified general revaluations allowing TAs to apply their rating policies. All general revaluations undertaken since the RVA came into force in July 1998 have been certified by the VG.

28. The objection process appears to be working well and provides an accessible and robust form of dispute resolution for ratepayers. The LVT receives very few requests each year to review TA objection decisions and few of the Tribunal's decisions are appealed to the High Court.

Concerns about system performance

29. Despite all general revaluations being certified, there is evidence that the system has performance issues that may affect its long-term viability.

One in five revaluations do not meet minimum standards the first time

30. The OVG assesses all general revaluations to ensure they meet the minimum standards prescribed in the Rules. Under section 11 of the RVA the VG either certifies that a revaluation meets the minimum standards, or if it does not, that rework is required.

31. Over the five years from 2014 to 2019, 135 general revaluations were completed. Of these, six had fundamental issues that required substantive rework, and a further 22 required moderate rework before they could be certified, i.e., approximately one in five or 20 percent were not certified the first time they were submitted.

32. In three cases the OVG (along with other experienced rating valuers of the VSP) supported the contracted VSP to get to the point where the revaluation could be certified.

Common themes in failing to achieve first time certification 2014-2019

33. Audit reporting prepared by the OVG identified these common themes across revaluations that did not achieve first time certification:

- High-level market movements since the previous revaluation (of all property types – rural, commercial and industrial, and residential property) not understood nor adequately analysed.
- Consideration of appropriate market sales evidence before confirming proposed values not comprehensive enough.
- Revaluation 'explanations', - i.e., the 'basis' for the link between sales evidence and valuations not clear enough.
- Some sales in the rural and land development sectors had not been considered as key sales, as they should have been, and analysed in the 'basis'.
- Other forms of market research (list prices, real estate agent opinions, etc) had not been sufficiently taken into account to generate more accurate values.
- Resource and other land use consents not adequately captured and valued.
- There was significant outstanding roll maintenance.

34. The OVG observe that the use of virtual and mapping tools may also assist in improving the accuracy of values.

The situation appears to be worsening

35. Twenty-two revaluations were completed in 2020, with 9 of those not meeting requirements (6 requiring moderate rework and 3 substantive rework) before they could be certified. Like many other revaluations since 2014 requiring rework, the failure to meet minimum standards for certification first time was caused by poorly done rural valuations. However, and for the first time, some of the revaluations completed in 2020 also had issues with urban property revaluations.

36. In the past, urban property values have largely been robust, but the 2020 OVG audit results across all property types suggest the system is more fragile than first thought.

Revaluations are becoming more complex

37. Revaluations are more likely to be of good quality and certified first time when:

- The property market is stable, or if market movements are universally rising (or falling) in a TA.
- There are few instances of land use change or other regulatory changes that require targeted analysis and application of values, rather than sole reliance on mass appraisal techniques.
- The TA has good consenting information, the VSP is familiar with the TA and the DVR of sufficient quality as a basis for revaluations to be made.

- The VSP has the capacity, capability and experience to make valuations.

VSPs have more difficulty valuing where there is land use change

38. Many instances of failure to meet the minimum standards for certification first time have arisen in the revaluation of land that has been the subject of rezoning (changes in use) or amenity. Common examples include land adjoining new transport routes or land rezoned as mixed or higher intensity use.

39. Rural land can be particularly difficult to revalue especially where it is subject to new regulatory requirements (eg, nitrogen caps that limit stock carrying capacity) or would benefit from new government funding such as for forestry planting. These changes effect economic benefit derived from the land, and therefore market value.

40. In many cases of land use change, mass appraisal techniques may not be appropriate due to the significant degree of profitability change (up and down) and/or changes in amenity or other factors that contribute to value. There may also be insufficient market sales to generate reliable values for those properties, which in turn requires a higher degree of secondary evidence.

Attempts at remediation by the Valuer-General

41. Over time the OVG has had to provide Valuation Service Providers more education and guidance than was originally intended, so that their valuations reach the minimum standard for certification.

42. The VG has only two statutory levers to ensure general revaluations are suitable for TAs to strike rates from:

    - Under s5 of the RVA, the VG can make rules to prescribe standards, specifications, and methodologies for the rating valuation process.

    - Under s11 of the RVA the VG certifies that the generally revalued DVRs meet the minimum standards prescribed in the Rules.

43. If the VG decides not to certify a general revaluation, the relevant TA must be notified of the decision and the reasons why, including specifying the areas where correction or improvement is required before the revaluation can be certified.

Support for quality control

44. In response to declining revaluation quality, the OVG has undertaken a range of actions aimed at lifting the quality of revaluations. The OVG has, for example:

    - Increased the visibility of the revaluation issues through direct post-revaluation reporting to TAs and VSPs including splitting the overall quality control audit score into urban and rural categories (2015).

- Held annual rating valuation workshops to try to improve the quality of rural revaluation (2014-20).
- Run graduate workshops at the Auckland revaluation launch with Auckland Council and VSPs leading into the Auckland revaluation (2017 and 2020).
- Held annual revaluation meetings to debrief VSPs and TAs.
- Presented at Society of Local Government Managers and rating practitioners' conferences.

Over-reliance on operational input from the OVG

45. In exercising the responsibilities under S11 of the RVA, the VG has provided more operational quality control to support valuation services than was required of him by the RVA. While this approach has served to underpin the performance of valuation services to date, it has also led in part to some TAs and VSPs relying on the VG and not sufficiently exercising their responsibility to consistently manage and deliver quality revaluations.

46. In November 2019, LINZ received operational policy advice clarifying the extent of the support the VG must provide to TAs under s11 of the RVA to help bring a general revaluation up to the required standard for approval. LINZ position is that:

    - it is not the VG's role to provide solutions to all problems the VG has identified
    - the VG could make clearer his requirements under s10 and s11 of the RVA to drive improvements in quality.

Relocating the responsibility for quality revaluations back with TAs

47. Given the advice received and that his efforts have not seen an improvement in the standard of revaluations and first-time certification, the VG has reoriented the feedback on improvement areas on how noncomplying revaluations can be remedied. He has moved away from detailed instructions and towards a high-level view with examples. His decision effectively relocates the responsibility for quality revaluations back to TAs and their contracted providers.

Valuation Service Provider failure or exit is key risk to system viability

48. VSPs maintaining the capacity and capability to meet the statutory requirement for New Zealand's TAs to revalue their DVR every three years has become a key system risk.

49. The OVG has observed, and VSPs have reported, that revaluation rework over multiple districts has resulted in:

- Operational delivery pressure – given the decreasing numbers of experienced and qualified rating valuers, rework affects the ability of a VSP to successfully deliver on their next revaluation. Over time, successive rework will have a compounding effect on the VSP's ability to deliver their overall programme.
- Unrecoverable costs – rework will mean additional costs, most of which are likely to be absorbed by VSPs because TAs will expect VSPs to consistently meet minimum standards first time.
- Staff burnout – rework often means VSP staff are required to work long hours during the revaluation process, which over the last three years has led to some staff becoming frustrated with the industry. This adds to the difficulty VSPs report they have in attracting and retaining experienced staff.

50. In the short-term, revaluation quality issues place further pressure on VSPs to absorb the financial impact and continue to rely on their staff enduring long and difficult revaluation processes. In the long-term, the financial and operational impacts could compound to the point where a VSP could exit the market.

Factors that could cause a VSP to exit the rating valuations system

Low prices for rating valuation services compromises quality and threatens viability

51. Price appears to be the most significantly weighted single criteria used by TAs to select their VSP when tendering their valuations services contract. Anecdotally average contract price per rating units appears to have either dropped or remained stable in real terms, despite increasing costs to VSPs. As an example, a recent contract let by a TA reinforces this point. The VSP who won the contract was scored less than their competitor on all procurement criteria except for price, which the TA confirmed was the deciding factor in their decision to award the contract. Some contracts have not been retendered for years. [7]

52. VSPs have had to find ways to reduce their costs. The OVG observes that this seems to have been at the expense of maintaining measures to ensure quality revaluations are submitted for certification, despite VSPs reporting significant investment in IT solutions.

53. It is not clear how long VSPs will be able to sustain their services at current contract prices particularly when faced with upward pressure on labour costs and the need to absorb costs of rework over the medium term.

[7] Dunedin in 2018 was the last time a South Island TA openly tendered their valuation services contract.

VSPs are struggling with capacity and capability issues

54. VSPs are struggling to maintain their experienced and skilled workforce. Many experienced valuers are close to retirement or are attracted away from rating valuation by other sectors demanding registered valuers, such as banking and data insights. At the same time, a dynamic residential property market has increased the demand for valuers by private valuation firms who look to the rating valuation workforce to fill shortages. Feedback from interviews made clear that salaries offered by banks and valuation firms doing private work, for example, make it more difficult for VSPs to attract and retain experienced rating valuers.

55. Evidence of a skill shortage can be seen when comparing the 2016 and 2019 'basis' documents. These show that fewer qualified valuation staff were involved in 2019 revaluations compared to those completed in 2016.

56. While VSPs continue to employ graduates, VSPs report that the pathway to registration for graduates undertaking rating valuation work can be difficult. Registration requires a certain amount of individual property valuation experience that is difficult for rating valuers to obtain, although it is possible through dealing with individual objections from ratepayers/owners.

57. Valuation qualifications are also not targeted towards rating valuation. Tertiary valuation degrees in New Zealand largely focus on educating undergraduates in the skills required to undertake private valuations, with only limited course material offered on the mass appraisal techniques required for rating valuation work.

Lack of investment in innovation and technology to support quality revaluations

58. VSPs report they have invested in a range of information technology over the last few years, but it appears that these investments have not fundamentally driven improved rating valuation services.

Significant entry barriers will likely compound the capacity problem

59. Uncertainty about the quality of a TA's DVR is a significant barrier for potential and current VSPs tendering for new contracts. Potential entrants said they have the skills to undertake rating valuations but saw the current market price as too low given the risk that they could be handed a DVR and associated information that was poorly structured, had errors, omissions, and other data quality issues.

60. Investing in alternative bespoke data management infrastructure to perform mass appraisals is also very expensive, and for smaller potential providers, financially prohibitive. Valuation firms spoken with were confident that they could perform revaluations, but without the ability to invest in appropriate database infrastructure, felt their entry was largely prohibited.

61. The dominant supplier of valuation services is in the best position to compete on price for contracts because it benefits from economies of scale, an advantage from when the current system was set up.

62. When new firms have entered the market for rating valuation services, almost all have failed over the short to medium term.

Weak incentives on TAs to manage quality does not help

63. Many TAs have a high degree of trust in their VSP to provide services that meet minimum standards and have little or no oversight on what is delivered. Instead, they rely on the OVG's audit and certification process to address any quality issues, and as long as revaluations are eventually certified, have little or no incentive to manage for quality.[8]

64. Overall, TAs (as the customers) have weak incentives, and in many cases lack the capability, to manage their contracts with VSPs to ensure that revaluations meet minimum standards first time. This appears to be a significant issue for the long-term performance of the system.

Consequences for territorial authorities of system failure

65. A continuation of the decline in quality is likely to make the incidence of non-certifications of general revaluations more frequent and put further pressure on the capacity of the Rating Valuation system.

66. Delays in certification and the requirement for rework could result in a loss of confidence in the system, and the number of objections to property values could increase.

67. VSP failure or exit from the market could compromise the Rating Valuation system.

68. TAs' inability to strike rates based on consistent, impartial, independent, and equitable valuations would ultimately undermine the credibility of the local government financing regime.

There are challenges ahead that the system will struggle with

69. Several councils have signalled that rates will have to rise significantly to fund shortfalls in infrastructure. This does not affect rating valuations per se, but higher rates will highlight issues of fairness and equity much more, and the need for

[8] That said, some TAs undertake their own analysis of the accuracy of the values that their VSP generates in the revaluation. Measures such as thematic mapping, being onsite during objection visits, and statistical techniques such as scatter plot analyses were all put forward as ways in which TAs assured themselves of the quality of the revaluation delivered by their VSP

accuracy in valuations. The number of households contesting their rating value will likely increase.

70. The Minister for Local Government has announced a Review into the Future for Local Government. The scope is broad, comprising what local government does, how it does it, and how it pays for it.[9] The Review could recommend changes to current TA boundaries. The Rating Valuation system will potentially need to be able to deal with rating valuations for new entities and across existing boundaries.

Actions that could be taken to improve performance

71. Improved system performance would see:

- TAs taking more active responsibility individually and collectively for the quality of their rating valuations and for the Rating Valuations system.
- Continued viability of VSPs and more certainty about the state of DVRs for new VSPs wanting to enter the rating valuations market.
- Rating valuation being an attractive career to attract and retain valuers.
- More focus on rating valuations in course offerings by tertiary institutions.

72. The biggest lever for improved system performance is for TAs to demand (through their contracts with VSPs) consistent, impartial, independent, and equitable revaluations, and for TAs collectively to act to ensure the future viability of the Rating Valuations system.

73. There are interventions that LINZ could also take to assist TAs to achieve quality revaluations. These interventions are outlined below.

Strengthen the market for rating valuations services

Strengthen incentives and capability of territorial authorities

74. The incentives and capability of TAs to manage for quality could be strengthened by:

- Developing standard valuation contracts that incorporate clauses relating to quality requirements. For example, agreeing with TAs and VSPs a standard contract template that could include:
  - more specific requirements for VSPs to provide quality assurance to the TA
  - clauses specifying the extent of the DVR information gathered for rating valuation purposes that must be provided to a newly contracted VSP.

[9] https://www.dia.govt.nz/Future-for-Local-Government-Review-Terms-of-Reference

- Reviewing existing guidance and developing further materials for TAs on how to carry out roll maintenance audits and undertake quality assurance on the valuation services they receive from their VSP. This review could perhaps be done in collaboration with Local Government New Zealand and/or the Society of Local Government Managers.

Improve competition in the rating valuation services market

75. Actions could be taken to reduce the barriers to entry for potential entrants into the rating valuations market. For example, the VG could:

    - Require that councils maintain an inventory of DVR-related assets to provide greater transparency for potential VSPs when tendering for contracts.
    - Implement an accreditation regime for VSPs to improve assurance to TAs of VSPs' competence and capability (and lessen risk for TAs in changing providers).
    - Require that DVR information be handed to a new VSP in a particular format/s.
    - Consider requiring all TAs to provide a mechanism that enables property owners to view and correct data to improve the quality of the DVR.

Change regulatory practices to better drive compliance

76. Regulatory practice actions that could be considered to better drive compliance include:

    - The VG evolving his approach to be less involved operationally in supporting revaluation quality when executing his certification responsibilities under s11 of the RVA.
    - Considering whether other incentive arrangements could be developed through the VG's rule-making powers.

77. Review the Rules to:

    - Review minimum standards where appropriate (particularly for rural and commercial and industrial property valuations).
    - Better enable automation and use of technology in mass appraisal methods.
    - Alter the DVR data structure and content to improve data quality and completeness.

78. As part of front-end monitoring practice, VSPs could be required to submit an annual plan to the OVG for approval, outlining how VSPs will ensure the revaluations they complete in that year will meet the minimum standards (including items such as resourcing and a commitment to address any improvement recommended from previous revaluation audit reports).

79. The OVG's audit function could be improved, for example:

- Scheduling roll maintenance audits (or alternatively, develop guidance for councils on how to carry out their own roll maintenance audits).
- Revising audit-scoring to capture more granular performance-based information.

80. LINZ could commit to an evaluation approach where:

- More detailed system performance information is collected to monitor and evaluate the effectiveness of regulatory interventions.
- The performance of the system is reviewed again (say in three years) with a view to assessing its long-term viability.

Improve rating valuation capability and capacity

81. To increase awareness and uptake of rating valuation as a career, the OVG could consider:

- Working more closely with universities to develop course material that includes more focus on rating valuation and mass appraisal methods.
- Working with VSPs to communicate the merits of rating valuation as a profession in universities.

82. To help increase the number of rating valuation graduates becoming registered, the VG could consider:

- Developing more effective communications to VSPs on how qualified rating valuers can be registered.
- Working with the VRB to:
    - Look at how the registration requirements could build in testing based on mass appraisal methods used in rating valuation.
    - Review registration requirements for overseas-trained valuers to ensure they are not overly burdensome and focus on their skill set and competence.