



**Land and Property Management
Authority**

**Rate of Return Review for
Domestic Waterfront
Tenancies on Crown Land in
NSW
Final Report**

February 2010
This report contains 114 pages
KPMG Final Report February 2010

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1 Executive summary

1.1 Background

The NSW Land and Property Management Authority (LPMA) has ownership, control and management of Crown land below the mean high water mark excluding Sydney Harbour and the Ports of Botany, Newcastle and Wollongong. Development, occupation or use of Crown land for residential purposes requires a licence from the LPMA. These are referred to as ‘domestic waterfront tenancies’ which are defined as:

Domestic waterfront tenancies are occupancies of an area of public land for private structures including jetties, swimming pools, seawalls, boatsheds and slipways. The land is submerged or reclaimed land.¹

Licences for domestic waterfront tenancies are typically issued by the LPMA for a term of 20 years or the life of the structure, whichever is lower, and licensees are required to pay an annual market based rent for the use and occupation of domestic waterfront facilities on Crown land.

Licence fees are determined by a rental formula, which was set by the Independent Pricing and Regulatory Tribunal (IPART) in its 2004 *Review into Rentals for Waterfront Tenancies on Crown land in NSW*.² There are four main components to the formula, these being statutory land values (SLVs) within a precinct, the occupancy area, a rate of return (ROR) which was initially set at 3.05 per cent, and a discount factor, initially set at 50 per cent. The rental formula is given by:

General Rent (\$) =	Precinct Statutory Land Value (\$/m ²) x Occupancy Area (m ²) x Rate of Return (3.05%) x Discount Factor (50%)
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Where:

- **Precinct Statutory Land Value (PSLV):** is a proxy for the market value of an occupancy. It is an amount (expressed in dollars per square metre) that is calculated by dividing the total SLV of all freehold tenured properties in the precinct where the occupancy is located (based on the Valuer-General’s SLVs for these properties) by the sum of the total areas of the freehold tenured properties in the precinct plus the total area of occupancies in the precinct. The LPMA uses a three-year rolling average for the PSLVs to determine rents, but is not limited to the current years.
- **Occupancy area:** is the land area of the individual property for which rent is to be charged.
- **Rate of return:** is the net ROR to the community on waterfront occupancies. It is calculated as the long-term gross ROR from residential rentals minus an allowance for outgoings.

¹ NSW Auditor-General (2009) Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW, p.12. Available from:

http://www.audit.nsw.gov.au/publications/reports/performance/2009/waterfronts/waterfront_tenancies.pdf

² IPART (2004) *Review into Rentals for Waterfront Tenancies on Crown land in NSW*. Available from: <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

IPART initially set this at 3.05 per cent, reflecting the 10-year average ROR for houses in the Sydney Statistical Division (SD)³ for the period January 1994 to December 2003 (which was 5.55 per cent, based on data from Residex), less 2.5 per cent, which was the estimated cost of outgoings.⁴

- **Discount factor:** reduces the rent by 50 per cent to take into account limitations on the property rights of licence holders as compared with property rights normally attaching to freehold land. It therefore includes factors such as the fact that the land is partially submerged, there are limitations on the structures which may be built on the land, and access across this land must be available to the community.

KPMG has been engaged by the LPMA to review and update the elements of the rental formula to ensure that it produces a market rent for the use of Crown assets. In particular, KPMG has been engaged to review the ROR, discount factor, and underlying methodology of calculating the various components of the formula, and to make recommendations. To undertake this review, KPMG has:

- released an *Issues Paper* outlining the key issues and offering stakeholders an opportunity to make submissions;
- reviewed the submissions in response to the *Issues Paper*;
- undertaken selected stakeholder consultation;
- completed an extensive desktop review and data analysis, using data from a wide range of sources;
- considered the three main policy considerations when formulating recommendations, these being simplicity, equity and efficiency; and
- prepared this report which details the analysis undertaken and the recommendations.

We have made reference to several stakeholder comments throughout the report to illustrate the different points of view on the key issues. We do not necessarily agree with the views presented. They are presented for transparency and to assist in demonstrating how we have come to our conclusions.

KPMG has prepared the recommendations based on the policy considerations of equity, efficiency and simplicity, and the supporting principles of consistency, transparency, objectivity and ensuring that the transaction costs of levying rents on domestic waterfront tenancies are minimised. KPMG acknowledges that, while our conclusions and recommendations are formed on this basis, it would be reasonable to draw alternative conclusions and recommendations, if different weights were attached to these objectives and principles.

³ The Sydney SD is defined by the geographical definitions specified in the Australian Standard Geographical Classification, where the Sydney SD includes the Blue Mountains and Central Coast regions. See ABS (2009) *Australian Standard Geographical Classifications*, Cat. No. 1216.0

⁴ A rental rate of return is calculated by dividing weekly rent by house prices, and multiplying this by 365 and dividing by seven. Typically median rents and median house prices are used.

As per our terms of reference, KPMG's recommendations, have not considered the LPMA legislative, policy or administrative matters that need to be considered and addressed in implementing the recommendations.

1.2 Terms of reference

The terms of reference of this engagement require KPMG to consider:

- a rates of return in other rental markets, and the validity of comparisons between domestic waterfront tenancies and these other rental markets;
- b whether the current rate of return and rental returns generally reflect, to the extent possible, a market rate;
- c legislative factors as they apply to waterfront occupancies;
- d the various unique aspects of domestic waterfront occupancies including comparatively low overheads;
- e any relevant policy matters, including (but not limited to) NSW Treasury directives regarding the leasing of public land;
- f financial returns to government from the leasing of public land;
- g how the rate of return(s) works in concert with the other elements of the rental formula; and
- h the relationship between the 50 per cent discount factor to the rate of return, and review of the discount factor.

1.3 Key issues considered

As part of the review, KPMG considered a number of issues, including:

- the basis on which KPMG's recommendations should be made, focussing on:
 - the underlying purpose as to why the LPMA charges rent on waterfront land below the high tide mark; and
 - key policy objectives, these being efficiency, equity and simplicity, including the importance of minimising volatility in licence fees;
- how market rent is defined, and whether the LPMA should continue to receive an income only return, or whether there may be a case for the LPMA to recover some capital gains through the rental formula;

- whether the current ROR is appropriate and, if not, how the ROR should be calculated, focussing on:
 - the most appropriate and accurate source of data, this being either data from Residex which IPART used initially in its Review, or data from Housing NSW and the LPMA;
 - the time horizon over which the ROR should be calculated, this being a 10-year rolling average as IPART initially used in its Review, or a shorter time horizon which more accurately reflects the current market conditions, either a three-year rolling average (which is in line with the way the LPMA calculates the precinct statutory land value, or PSLV) or a one-year average;
 - the geographic region over which the ROR is calculated, either keeping this as the Sydney region as IPART did in its initial Review, or changing to more geographically specific RORs by, for example, calculating RORs at a macro precinct level;
 - how frequently the ROR should be updated, either annually, every two years, every three years or every five years;
 - whether there may be a case to shift to updating rents by CPI on a year-to-year basis, and periodically updating the entire formula (for example every three years); and
 - the most appropriate way of adjusting the gross ROR to a net return (excluding the outgoings which residential property owners incur but the LPMA does not), the size of the adjustment required, and whether there may be a need for the ROR to be adjusted upwards to include the outgoings the LPMA incurs in managing the waterfront Crown land;
- whether the current discount factor is appropriate and if not, what the appropriate factor or factors should be, focussing on the:
 - underlying basis for applying a discount factor to waterfront land under the mean high tide mark;
 - way in which the Valuer-General obtains SLVs for waterfront land; and
 - whether there is a case to vary the discount factor depending on the geographic location, type of structure located on the land, and whether a property is only accessible by water.

Each of these issues was considered in light of the results of KPMG's desktop and data analysis, review of submissions, and stakeholder consultations to formulate the recommendations presented below.

1.4 Recommendations

Based on the information available and the analysis undertaken in the report, KPMG recommends that the LPMA update the ROR based on data from Housing NSW, using a three-

year rolling average for the period to the June quarter and subtracting residential property owner outgoings of 1 per cent to obtain a net ROR. In terms of recovering the LPMA's administration costs, KPMG presents two options, these being either a two-part tariff (i.e. charging a flat administrative fee plus a return) or including the LPMA's outgoings in the ROR. In both cases, there would appear to be merit in removing legislated minimum rent.

In addition, KPMG recommends either recalculating the market rent using the IPART general formula every year or every three years, then updating rents annually by indexing rent payments to the Sydney headline CPI measure (as published by the ABS). KPMG recommends that the ROR continue to be calculated using data from the Sydney region, and that the single 50 per cent discount factor remains in place. The exact application of these recommendations is detailed in Box 1.1.

KPMG believes that there may be merit in undertaking a more comprehensive review of the IPART general formula in 2012, at which time either IPART could undertake a full review of the rents charged on domestic waterfront tenancies, or the LPMA and Maritime Authority of NSW (Maritime) could perhaps work together to undertake such a review.

Box 1.1: Method to update the rates of return and rents

- 1 Obtain quarterly time series data from Housing NSW on the median rent and median sales price for all houses (i.e. irrespective of the number of bedrooms) in the Sydney Statistical Division
- 2 Divide the median weekly rent for the Sydney Statistical Division by the median sales price, multiply this by 365 and divide by 7 to obtain a ROR (per cent) for each quarter
- 3 Take an average of the RORs for the three years up to and including the latest June quarter (i.e. include 12 quarterly observations) to obtain a three year rolling average ROR
- 4 Subtract one percentage point from the gross ROR calculated in Step 3 to obtain a net ROR
- 5 Based on how the LPMA wishes to recover its estimated administration costs of \$1.7 million, either:
 - a increase the ROR by 0.84 percentage points,⁵ and add this to the net ROR calculated in Step 4, then use this calculated ROR to determine rents based on the IPART formula (i.e. Rent = Calculated ROR x PSLV x occupancy area x 50 per cent) in year 1; or
 - b use the net ROR calculated in Step 4 to determine rents based on the IPART formula (i.e. Rent = Net ROR x PSLV x occupancy area x 50 per cent) in year 1 and then add \$250 in administration costs to the calculated rent.

More detail on each of KPMG's recommendations in relation to the terms of reference of the review is provided below.

- **Income only return:** the ROR should remain as an income only return.
- **Data sources:** the data source for estimating the ROR should change to Housing NSW data, as it would appear to be a less volatile data source.
- **Geographical averaging:** the Sydney SD should remain as the geographical area for averaging given that the majority of licensees for which the rental formula is used (i.e. pay

⁵ See Section 5.6.2 for more detail on how this figure of 0.84 per cent is calculated.

more than minimum rent) are located in this region. Moreover, the quality of the data to determine macro precinct based rates of return would appear to be insufficient for use at this time. In the meantime, the LPMA could work with Housing NSW to set up a database and collect sufficient data based on macro precincts for consideration at the next time it undertakes a review.

- **Time horizon and frequency of updating the rate of return:** three options are worthy of consideration.
 - **Option A:** three-year rolling average ROR (for the three years to the June quarter), updated each year;
 - **Option B:** 10-year rolling average ROR (for the 10 years to the June quarter), updated each year; or
 - **Option C:** three-year average ROR (for the three years to the June quarter), with rent each year increased by the CPI for the Sydney region (based on data from the ABS) and the rental formula recalculated every three years.

Of the three options, Options A and C would be the most appropriate. Both Options match the time periods for PSLVs and the ROR and use more recent data which would appear to be more consistent with the concept of market rent. Option C has the advantage of increasing in line with inflation, which is consistent with observed evidence for annual rent increases in other rental markets, and also has the advantage of managing the volatility in rents. However, Option C could be subject to step changes (i.e. large increases in the year the rental formula is recalculated), unlike Option A where the rental formula is recalculated each year.

- **Net rate of return:** the estimate of outgoings should be revised to more accurately reflect current market conditions. The available evidence would appear to support an outgoings figure of 1.0 per cent.
- **LPMA outgoings:** should be included in the ROR. The LPMA have indicated that their current outgoings are approximately \$1.7 million per annum.⁶ The LPMA has two main options to recover their outgoings, which are:
 - charging each licensee a flat administration fee of \$250, in addition to the rent as calculated using the general rental formula; or
 - adding 0.84 per cent to the net rate of return (which is the percentage required to recover \$1.7 million in administrative costs).⁷

Both options would allow the LMPA to recover \$1.7 million, based on 2009 data. However each would have different distributional impacts, with the first option requiring all licensees to pay the same share of administration costs, and under the second option the share of administration costs paid would be linked to the PSLV and occupancy area. Under both

⁶ KPMG has not reviewed these costs and, as such, we have no view on the level of those costs.

⁷ See Section 5.6.2 for more detail on how this figure of 0.84 per cent is calculated.

options, the minimum rent would need to be abolished otherwise more than \$1.7 million would be recovered in administration costs.

Table 1.1 Impact of different options on the rate of return

	Three-year rolling average ROR, two part tariff, 2009	Three-year rolling average ROR, LPMA outgoings in ROR, 2009	IPART ROR
Gross rate of return	3.74%	3.74%	5.55%
Residential property outgoings	(1.00)%	(1.00)%	(2.50)%
LPMA outgoings*	\$250 per licence not included in the ROR	0.84%	0.00%
Net rate of return**	2.74%	3.58%	3.05%

* See Section 5.6.2 for more information on how the 0.84 per cent figure is calculated.

** Rate of return is calculated using data for the three years to June 2009

Source: Housing NSW; IPART; LPMA; KPMG estimates

- **Discount factor:** the single 50 per cent discount factor should remain. There is a lack of evidence to support altering it or to apply varying discount factors.
- **Next review:** the LPMA may wish to undertake a more thorough review of the IPART formula in its entirety (including the PSLVs) next time it intends to review the rate of return, either by referring the matter to IPART for reconsideration, or by possibly undertaking a comprehensive review in conjunction with Maritime. We suggest that the review consider, amongst other things:
 - if and once sufficient data has been collected to undertake the analysis, consider the feasibility of using macro precinct based rates of return and whether that might more effectively meet the relevant objectives in setting licence fees;
 - analysis of the LPMA's costs in managing licences, and the cost effectiveness of these; and
 - better understanding the data sources that underpin the discount factor. This should include working with the Valuer-General and the Valuer-General's advisors to better understand the data used to calculate the PSLVs to assist in the estimation of the discount factor and the possible estimation of different discount factors, for example:
 - by comparing the value of the Crown land to the average of adjoining freehold and the Crown land to more accurately evaluate the appropriateness of the discount factor; and
 - the difference in the value of land based on the structures that are currently situated on the land, to determine whether different discount factors should be applied in different circumstances.

We understand that Maritime is planning to review the entire formula in 2012. This may be an opportune time for the LPMA and Maritime to work together to consider the factors mentioned above and to ensure the rents charged are consistent and appropriate. An alternative would be to have the matter referred to IPART for a comprehensive review.

Impact of the recommendations on rents and LPMA revenues

Table 1.2 shows the impact of our recommendations had they been applied from 2004 onwards. The estimates are based on the Sydney SD,⁸ using the average growth in Sydney SLVs for a 100 square metre property. Two key observations can be made from this table.

- when the LPMA's outgoings are included in the ROR (as opposed to a flat fee in a two-part tariff), the rental estimates are higher; and
- rents that grow in line with CPI tend to be less volatile and move more consistently with trends in rents on residential property relative to the rents calculated by annually updating the ROR or keeping the ROR constant at the initial rate set by IPART, at 3.05 per cent.

Table 1.2 Historical estimates of rent based on KPMG recommendations

	2004	2005	2006	2007	2008	2009
Rents						
Current (3.05% ROR)	\$1,525	\$1,680	\$1,732	\$1,721	\$1,737	\$1,719
Updated annually*						
Two part tariff	\$1,328	\$1,294	\$1,332	\$1,423	\$1,578	\$1,795
Included in ROR	\$1,529	\$1,532	\$1,577	\$1,660	\$1,809	\$2,016
Updated by CPI*						
Two part tariff	\$1,328	\$1,360	\$1,412	\$1,437	\$1,498	\$1,518
Included in ROR	\$1,529	\$1,566	\$1,626	\$1,654	\$1,725	\$1,748
Growth in rents						
Current (3.05% ROR)	-	10.2%	3.1%	-0.6%	0.9%	-1.1%
Updated annually*						
Two part tariff	-	-2.5%	2.9%	6.8%	10.9%	13.7%
Included in ROR	-	0.2%	2.9%	5.3%	8.9%	11.5%
Updated by CPI*						
Two part tariff	-	2.4%	3.8%	1.7%	4.3%	1.3%
Included in ROR	-	2.4%	3.8%	1.7%	4.3%	1.3%

* Three-year rolling average ROR calculated using Housing NSW data for the Sydney SD, using data for the June quarter year end.

Note: Assumes that the PSLV is \$1,000 in 2004 and this increases at the rate of growth in the three-year rolling average house prices for the Sydney SD, the occupancy area is 100 square metres, the discount factor is 50 per cent, and residential property owner outgoings are 1 per cent. The administration charge under the two-part tariff is \$250 in 2009, which is then reduced in line with historic inflation. The administrative charge when included in the ROR is 0.84 per cent.

Source: Housing NSW; LPMA; KPMG calculations

Table 1.3 presents historical estimates of the rent based on the IPART formula being first used in 2004 and then again in 2007, with rents indexed to inflation in the years between the rental reviews (i.e. when the rental formula is recalculated). Based on this example, the two-part tariff provides the less volatile result, with rents increasing by 0.8 per cent in 2007 when rents are

⁸ The Sydney SD is defined by the geographical definitions specified in the Australian Standard Geographical Classification, where the Sydney SD includes the Blue Mountains and Central Coast regions. See ABS (2009) *Australian Standard Geographical Classifications*, Cat. No. 1216.0

recalculated with the IPART formula, compared with an increase of 2.1 per cent in that year, when the LPMA administrative costs are recovered through the ROR.

*Table 1.3 Historical estimates of rent based on CPI adjustments and formula updating every 3 years**

	2004	2005	2006	2007	2008	2009
Rents						
Two part tariff	\$1,328	\$1,360	\$1,412	\$1,423	\$1,484	\$1,504
Included in ROR	\$1,529	\$1,566	\$1,626	\$1,660	\$1,731	\$1,754
Growth in rents						
Two part tariff	-	2.4%	3.8%	0.8%	4.3%	1.3%
Included in ROR	-	2.4%	3.8%	2.1%	4.3%	1.3%

* ROR calculated using data for the year to the June quarter

Table 1.4 demonstrates the potential rent that licensees may expect to pay over five different precincts using a three-year rolling average ROR (for the three years to the June quarter) and the two methods of recovering the LPMA's administrative costs, these being a two part tariff and including the cost recovery component in the ROR. It is calculated using Housing NSW data for the Sydney SD, residential property owner outgoings of 1 per cent, and rent calculated using the formula in 2009 and indexed in the following years by CPI. Note that the estimates are indicative only, and based on a number of assumptions (including that rent is increased in line with CPI in 2010 and 2011). We also base our estimates on the value of 2009 PSLVs and the assumption that the occupancy area is 100 square metres.

It shows that if these methodologies for calculating the ROR were used in 2009 the rent payable by a licence holder in the Brisbane Water West precinct would be \$1,495 using a two part tariff and \$1,625 if the LPMA outgoings are recovered through the ROR. This compares to the current level of \$1,385. These rents could then grow by CPI each year for the next two years (e.g. \$1,541 and \$1,675 in 2010 and \$1,588 and \$1,726 in 2011), if the method of updating with CPI was chosen.

It is important to note that had the ROR methodology changed from the current rate of 3.05 per cent to the 3-year rolling average ROR (for the three years to the June quarter 2009) less one percentage point for outgoings, which is equivalent to 2.74 per cent, plus an administrative charge of \$250 per licensee, and minimum rent was abolished then:

- the total share of licensees that would see rents fall is 28 per cent; and
- one third of all licensees would pay less than \$500 a year in rent payments.

If the rate had changed to the three-year rolling average ROR (for the three years to the June quarter 2009) less one percentage point for outgoings, plus 0.84 per cent to recover the LPMA's administrative costs,⁹ which is equivalent to a ROR of 3.58 per cent, then:

- the total share of licensees that would see rents fall is 39 per cent; and
- 47 per cent of licensees would pay less than \$500 a year in rent payments.

⁹ See Section 5.6.2 for more detail on how this figure of 0.84 per cent is calculated.

Table 1.4 Potential rents for five macro precincts using new methodology

	2009 current	2009 new	2010	2011
Brisbane Water West				
Two part tariff	\$1,385	\$1,495	\$1,541	\$1,588
Included in ROR	\$1,385	\$1,625	\$1,675	\$1,726
Georges River 2				
Two part tariff	\$1,472	\$1,573	\$1,622	\$1,671
Included in ROR	\$1,472	\$1,728	\$1,780	\$1,835
Lake Macquarie 1				
Two part tariff	\$874	\$1,035	\$1,067	\$1,100
Included in ROR	\$874	\$1,025	\$1,056	\$1,089
Pittwater 2				
Two part tariff	\$2,267	\$2,287	\$2,357	\$2,429
Included in ROR	\$2,267	\$2,660	\$2,741	\$2,825
Port Hacking 1				
Two part tariff	\$1,928	\$1,982	\$2,043	\$2,106
Included in ROR	\$1,928	\$2,262	\$2,331	\$2,402

Notes: 'Current' is using a net ROR of 3.05 per cent. 'New' is based on the ROR of 2.74 per cent for the two-part tariff and 3.58 per cent for 'Included in ROR'. Rents are calculated using the IPART formula in 2009, based on the assumption that the occupancy area is 100 square metres, discount factor is 50 per cent, and PSLV is the three year rolling average for the respective area. In 2010 and 2011 the rents are estimated by increasing the '2009 New' rent by the inflation rate, which we take as the average annual growth in CPI rents for the Sydney region over the 10 years to June 2009, which was 3.5 per cent.

Source: ABS (2009) Consumer Price Index, Australia; Housing NSW; LPMA

Finally, Table 1.5 shows the impact of the changes in the methodology on the LPMA's revenue, had they been introduced in 2009 (based on the assumption that there are no rebates and waivers, hence reflects gross revenue).¹⁰ It shows that by updating the ROR, using a three-year averaging approach (for the three years to the June quarter 2009), removing 1 percentage point for the outgoings of a residential property and including the LPMA's outgoings will lead to an expected increase in revenue of approximately \$0.42 million, or 6.2 per cent from its current level. Thus the increase in revenue under the two scenarios where the LPMA's costs are recovered is due to both increased administration costs charged which is offset by the impact of a lower net rate of return (from 3.05 per cent down to 2.74 per cent, which is equivalent to the rolling average for the three years to the June quarter 2009).

Table 1.5 Impact of change in methodology on LPMA revenue

Methodology	Revenue, 2009	Change in revenue
ROR at 3.05 per cent	\$6.81m	-
Three-year average ROR and LPMA outgoings recovered with two-part tariff	\$7.23m	6.2%
Three-year average ROR and LPMA outgoings recovered through ROR	\$7.23m	6.2%

¹⁰ Rebates and waivers are provided to licensees that have water access only, are pensioners, are located in Crystal Bay or Horseshoe Cove, and for the phase in of rental increases (including from the introduction of the IPART formula in 2004 and changes to the precincts which occurred in 2008). In 2009, rebates and waivers totalled \$506,067, or 7.5 per cent of gross revenue.

2 Purpose and approach

2.1 Purpose of the report

The NSW Land and Property Management Authority (LPMA) has ownership, control and management of Crown land below the mean high water mark excluding Sydney Harbour, and the Ports of Botany, Newcastle and Wollongong. Development, occupation or use of Crown land for residential purposes requires a licence from the LPMA. These are referred to as ‘domestic waterfront tenancies’ which are defined as:

Domestic waterfront tenancies are occupancies of an area of public land for private structures including jetties, swimming pools, seawalls, boatsheds and slipways. The land is submerged or reclaimed land.¹¹

Licences for domestic waterfront tenancies are typically issued by the LPMA for a term of 20 years or the life of the structure, whichever is lower, and licensees are required to pay an annual market based rent for the use and occupation of domestic waterfront facilities on Crown land. Licence fees are determined by a rental formula, which was set by the Independent Pricing and Regulatory Tribunal (IPART) in its 2004 *Review into Rentals for Waterfront Tenancies on Crown land in NSW*.¹² There are four main components to the formula, these being statutory land values (SLVs) within a precinct, the occupancy area, a ROR, and a discount factor.

The LPMA is seeking to review and update the elements of the rental formula set by IPART to ensure that it produces a fair market rent for the use of Crown assets. Whilst the principal focus of the review is on the value to ascribe to the ROR, LPMA also intends to consider any views on the discount factor and other elements of the rental formula.

KPMG has been engaged by the LPMA to undertake this review, and make recommendations about the appropriate ROR, discount factor and the underlying methodology of calculating the various components of the formula.

2.1.1 Terms of reference

The terms of reference of the engagement require the consultant to consider:

- a rates of return in other rental markets, and the validity of comparisons between domestic waterfront tenancies and these other rental markets;
- b whether the current rate of return and rental returns generally reflect, to the extent possible, a market rate;
- c legislative factors as they apply to waterfront occupancies;

¹¹ NSW Auditor-General (2009) Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW, p.12. Available from:

http://www.audit.nsw.gov.au/publications/reports/performance/2009/waterfronts/waterfront_tenancies.pdf

¹² IPART (2004) *Review into Rentals for Waterfront Tenancies on Crown land in NSW*. Available from: <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

- d the various unique aspects of domestic waterfront occupancies including comparatively low overheads;
- e any relevant policy matters, including (but not limited to) NSW Treasury directives regarding the leasing of public land;
- f financial returns to government from the leasing of public land;
- g how the rate of return(s) works in concert with the other elements of the rental formula; and
- h the relationship between the 50 per cent discount factor to the rate of return, and review of the discount factor.

The formula itself is not the subject of KPMG's review, nor is the efficiency or otherwise of LPMA in managing the licensing of these properties. We have been instructed by the LMPA in regards to their costs in managing the licensing system and therefore have not reviewed the efficiency or otherwise of them. In addition, as per our terms of reference, KPMG's recommendations, have not considered the LPMA legislative, policy or administrative matters that need to be considered and addressed in implementing the recommendations.

2.2 Our approach

To conduct the review of the ROR on domestic waterfront tenancies on Crown land, in line with the agreed project plan, KPMG has undertaken the project in five key steps which are:

- project initiation and development of methodology;
- stakeholder consultation;
- desktop research, information collection and analysis;
- review of issues arising from stakeholder consultations; and
- reporting.

We have made reference to several stakeholder comments throughout the report to illustrate the different points of view on the key issues. We do not necessarily agree with the views presented. They are presented for transparency and to assist in demonstrating how we have come to our conclusions.

2.3 Report structure

This report is structured as follows:

- **Section 3** includes background information on the role of the LPMA in managing waterfront tenancies, the IPART review and the general rental formula, and recent issues pertaining to rents on domestic waterfront properties.

- **Section 4** discusses the concept of market rent, in the context of the return that the LPMA should be receiving on waterfront tenancies. It also discusses the policy objectives that should be considered in setting market rents, and whether it is appropriate for the rental return to be income only (as is currently the case) or whether there is a case for the LPMA capturing part of any capital gain.
- **Section 5** focuses on the ROR, in particular how it is calculated, and the frequency with which it is updated. The data sources, time horizon and geographic regions over which rental returns are calculated are all discussed, as well as the way in which net rent is derived from the gross rental data.
- **Section 6** analyses the discount factor and the justification for it, and evaluates what the factor should be, and whether the level of the discount should vary by region and/or type of structure erected on the land.

In addition, the report contains six appendices, which include the following:

- **Appendix A** is a glossary of the key terms and acronyms.
- **Appendix B** provides information on the macro precincts used by the LPMA.
- **Appendix C** includes information on the consultation process, including the parties that made submissions, those with whom face-to-face interviews were conducted, issues consulted on, and the key issues raised in the submissions and consultations.
- **Appendix D** presents the recommendations from the Auditor-General's report.
- **Appendix E** provides information on how the rents paid by licensees have changed over recent years.
- **Appendix F**: presents our detailed analysis for selected sections of the report.

3 Background

This section provides an overview of the role of the LPMA in managing waterfront tenancies, the IPART review and the general rental formula, recent issues pertaining to rents on domestic waterfront properties and the key considerations underpinning the current review.

3.1 Overview of Land and Property Management Authority's role in managing domestic waterfront properties

As described in more detail in Section 2, the NSW LPMA has ownership, control and management of Crown land below the mean high water mark and it issues licences to tenants. Licence fees are determined by a rental formula, which was set by IPART in its 2004 *Review into Rentals for Waterfront Tenancies on Crown land in NSW*¹³. This formula is:

$\text{General Rent (\$)} = \text{Precinct Statutory Land Value (\$/m}^2\text{)} \times \text{Occupancy Area (m}^2\text{)} \times \text{Rate of Return (3.05\%)} \times \text{Discount Factor (50\%)}$
--

Where:

- **Precinct Statutory Land Value (PSLV):** is a proxy for the market value of an occupancy. It is an amount (expressed in dollars per square metre) that is calculated by dividing the total SLV of all freehold tenured properties in the precinct where the occupancy is located (based on the Valuer-General's SLVs for these properties) by the sum of the total areas of the freehold tenured properties in the precinct plus the total area of occupancies in the precinct. The LPMA uses a three-year rolling average for the PSLVs to determine rents, but is not limited to the current year.
- **Occupancy area:** is the land area of the individual property for which rent is to be charged.
- **Rate of return:** is the net ROR to the community on waterfront occupancies. It is calculated as the long-term gross ROR from residential rentals minus an allowance for outgoings. IPART initially set this at 3.05 per cent, reflecting the 10-year average ROR for houses in the Sydney Statistical Division (SD)¹⁴ for the period January 1994 to December 2003 (which was 5.55 per cent, based on data from Residex), less 2.5 per cent, which was the estimated cost of outgoings.¹⁵
- **Discount factor:** reduces the rent by 50 per cent to take into account limitations on the property rights of licence holders as compared with property rights normally attaching to freehold land. It therefore includes factors such as the fact that the land is partially submerged, there are limitations on the structures which may be built on the land, and access across this land must be available to the community.

¹³ IPART (2004) *Review into Rentals for Waterfront Tenancies on Crown Land in NSW*. Available from: <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

¹⁴ The Sydney SD is defined by the geographical definitions specified in the Australian Standard Geographical Classification, where the Sydney SD includes the Blue Mountains and Central Coast regions. See ABS (2009) *Australian Standard Geographical Classifications*, Cat. No. 1216.0

¹⁵ A rental rate of return is calculated by dividing weekly rent by house prices, and multiplying this by 365 and dividing by seven. Typically median rents and median house prices are used.

3.2 IPART review of rents on domestic waterfront properties

In October 2003, the Premier of NSW asked IPART to review and report on the rent that the Government should charge for the use of public land below the mean high water mark. The terms of reference of the review required IPART to determine a suitable approach for setting rentals over waterfront tenancies, with the aim to:

- align rental returns to reflect and maintain market values;
- ensure that rents cover, at a minimum, administration costs;
- consider tenants' ability to pay, including the situation of pensioners; and
- consider appropriate equity arrangements for tenants in special circumstances (such as those who have only water-based access to their properties).

IPART was also asked to review and report on mechanisms to streamline the administration of domestic waterfront tenancies, in particular focussing on:

- the different legislative requirements in the administration of licences, leases or other instruments used; and
- the most appropriate basis of terms and conditions associated with these instruments.

The report, *Review into Rentals for Waterfront Tenancies on Crown land in NSW*, made a number of observations and recommendations, these being:

- any approach for setting rentals for domestic waterfront tenancies should recognise that the land in question is a valuable asset, and the NSW Government, on behalf of the community, is entitled to a reasonable return on this asset;
- rentals should be aligned with the market value of the land below the mean high tide mark over which the licences are held;
- the rentals should be set according to the general formula (shown in Section 3.1);
- long-term licences should be used as the occupancy instrument, and these should be able to be transferred to a new owner if a licensee sells the adjoining freehold land;
- for existing rights holders, the new rentals should be phased in over a two to six year period, depending on the size of the increase;
- pensioners should have the increase in rent phased in over seven years, and after this time their rent should be capped at \$1,000 or 50 per cent of the rent calculated by the formula, whichever is lower;
- rights holders who have water access only to their freehold properties should receive a rebate of \$250 (in 2004, indexed to the CPI); and

- to cover administration costs, the minimum rental (which applies to licence holders whose calculated rent from the formula is at or below the minimum rent level) should be set at \$350 (in 2004, indexed to CPI).

These recommendations were adopted by the LPMA, and rents have been set according to the general formula since July 2004. In terms of updating the values used in the formula, IPART did not prescribe a timeframe for review. However, IPART did note that:

- *“The Tribunal believes the use of regularly updated SLVs (typically between one and three years) to determine the PSLV component of the general rental formula means that these rentals will maintain their alignment with the market value of occupancies as this value changes over time;”¹⁶ and*
- *“The Tribunal believes a 3.05 per cent rate of return is appropriate. However, this rate of return will need to be reviewed regularly.”¹⁷*

Therefore, apart from noting that a ‘regular’ review was required, the Tribunal was not specific on the timeframe for revisiting the components in the rental formula. In practice, the LPMA has been updating the SLVs each year to calculate the annual rent for domestic waterfront properties on Crown land but has not updated the ROR or the discount factor since IPART’s review.

3.3 Recent issues pertaining to rents on domestic waterfront properties

The LPMA manages licences with over 6,700 waterfront tenancies in NSW, the majority of which are in the Lake Macquarie, Georges River, Port Hacking, Pittwater, Brisbane Water and Hawkesbury River regions. These licences cover a total occupancy area of 750,000 square metres of Crown land, with the average occupancy in 2009 of 111 square metres.

Table 3.1 shows the number of licences and revenue earned by the LPMA for both licensees paying minimum rent, and those paying more than minimum rent. It shows that while only half of the licensees pay more than minimum rent, these licensees account for nearly 80 per cent of the revenue earned by the LPMA from this source. Revenue from this source accounts for only approximately 3 per cent of the LPMA’s revenue from customer sales, and just over 2 per cent of the LPMA’s total revenue.¹⁸

¹⁶ IPART (2004) Review into Rentals for Waterfront Tenancies on Crown land in NSW, p.20. Available from <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

¹⁷ Note that this is a net rate of return, net of outgoings. See IPART (2004) Review into Rentals for Waterfront Tenancies on Crown land in NSW, p.21. Available from <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

¹⁸ Based on projections of the LPMA’s revenue for 2008-09, from LPMA (2009) *Annual Report 2007-08: Financial Overview*, available from: http://www.lands.nsw.gov.au/media/lands/pdf/annual_reports/ar_200708/2008_AR_Financial_overview_LowRes.pdf

Table 3.1 Characteristics of the LPMA's portfolio of waterfront properties

	Paying minimum rent	Paying above minimum rent	Total
Number of licences	3,331	3,457	6,788
Share of total number	49%	51%	
Gross revenue earned	\$1.23m	\$5.57m	\$6.81m
Share of gross revenue	18%	82%	
Net revenue earned*	\$1.33m	\$4.97m	\$6.30m
Share of net revenue	21%	79%	

* Net revenue is less rebates and waivers, which are provided to licensees that have water access only, are pensioners, are located in Crystal Bay or Horseshoe Cove, and for the phase in of rental increases (including from the introduction of the IPART formula in 2004 and changes to the precincts which occurred in 2008). In 2009, rebates and waivers totalled \$506,067, or 7.5 per cent of gross revenue.

Since the Tribunal's report, the LPMA has been charging market rent based on the general formula (with the increase in rents being phased in over a two to seven year period for existing licensees). Prior to this, the rents for many existing licensees had been considerably lower, and had not changed for 15 years. As such, the change to more market based pricing led to some concern among licence holders, which have been reflected in complaints to the LPMA.

The LPMA adjusts the SLVs in the general formula on an annual basis, but applies to the SLVs a ROR which is fixed at 3.05 per cent a year. Due to year to year fluctuations in SLVs, tenants have experienced fluctuations in rent, some significantly more so than others. In an attempt to smooth out these fluctuations, the LPMA moved to adopt three-year rolling average land values based on 'macro precincts' from February 2009. This change has reduced the number of waterway precincts that the LPMA uses for the purpose of calculating rent for domestic waterfront facilities from 429 to 54. The three-year rolling average of SLVs, in combination with the macro (larger) precincts, was designed to smooth out any large movements caused by significant movement in the revaluation of land.¹⁹

In August 2009, the Auditor-General of NSW released a report, *Auditor-General's Report: Performance Audit on Administering Domestic Waterfront Tenancies*, which was motivated by a number of complaints the Auditor-General had received in the preceding two years from tenants. As part of the audit, the Auditor-General undertook discussions with the LPMA and Maritime, as well as Members of Parliament. Approximately 170 submissions from tenants were received, voicing concerns mainly in relation to revisions to administrative practices, and concerns that the IPART recommendations had not been implemented appropriately.

The Auditor-General found that:

- both agencies were largely administering the tenancies in line with the IPART report recommendations;
- however, there were some areas in which the agencies were not consistent with the IPART report recommendations in relation to:

¹⁹ See Department of Lands (2008) Domestic waterfront tenancies – Changes in Rents. Available from http://www.lands.nsw.gov.au/media/lands/pdf/crown_lands/brochures/DWF_fact_sheet.pdf

- reviewing the ROR in the general rental formula regularly (it has not been reviewed since the IPART report was released);
- the LPMA adjusts the minimum rent by the CPI quarterly instead of annually;
- annual rent increases for some of the LPMA's tenants exceeded the cap of \$2,500 plus CPI, although the average rent increase over the phase-in period was below this; and
- the two agencies differ in how they administer the tenancies in relation to:
 - how the phase-in rent increases were calculated;
 - the rebates available to pensioners; and
 - including the occupancy areas in the precinct statutory land calculations (with the LPMA not including these consistently).

The Auditor-General made seven recommendations, as detailed in Appedix E, which has informed the Terms of Reference provided to KPMG for this review.

Stakeholders have also drawn attention to another recent development, this being a case in the Local Land Board of NSW (File number LB 09-28) relating to rents on a waterfront tenancy.

3.4 Key issues and considerations in current review process

This section discusses some of the key issues that may be relevant to KPMG's review.

3.4.1 Purpose of charging rent on waterfront land below the mean high tide mark

In its 2004 review, IPART noted that:

“From the community's point of view, waterfront public land provides several broad benefits, including environmental, social and economic benefits. In addition, the value of these benefits may be reduced by structures associated with private occupancies over this land.”²⁰

The IPART review also noted that ‘several submissions’ commented that the structures built on waterfront occupancies can diminish many of these ecological, social and economic values by:

- damaging foreshore habitats and fragmenting the marine ecology;
- obstructing public passage along the foreshore, and creating uncertainty about the public's access rights in these areas;
- reducing the visual amenity of these areas; and

²⁰ IPART (2004) “Review into Rentals for Waterfront Tenancies on Crown land in NSW”, p.12.

- increasing boat traffic in these areas.”²¹

At the same time, some stakeholders also suggested that some types of structures, including pontoons and reclamations, can improve public amenity rather than reduce it. For example, one stakeholder stated:

“The pontoons on this shore do not alienate the shore from the public; they actually make the shore more accessible. The same can be said for much reclamation in the area. They make more accessible a shoreline that is unusable otherwise.”

“In other cases where structures such as swimming pools or residences are built on public land then there should be a reasonable rent paid but there should be some consideration of the nature of the structure and whether it enhances or diminishes the shore as far as the public is concerned.”²²

Whether it is the case that structures add value for the public is subject to debate and opinion. However, the granting of a licence shifts in part, the decision on how this land can be utilised from the broader public to the licensee. As licensees derive private benefits from use of such land, the *Crown Lands Act* requires them to pay market rates for the rent.

3.4.2 Policy objectives

There are a number of notable features with the task of setting market rents for domestic waterfront tenancies. Most notably:

- market rent is reasonably easy to define in concept, but it is very difficult to define in practice as it is always difficult to establish market prices in the absence of deep and transparent markets:
 - under ideal circumstances, the IPART rental formula would be applied with directly observable data on land values and rates of return specific to waterfront tenancies on Crown land. However, there is limited data of this nature which is available;
- applying a formula to derive market rent involves converting that concept into practice, which will always involve a degree of compromise of principle for practice. For example the SLVs estimated by the Valuer-General as part of their valuation of the adjoining freehold land. Land valuation is not an exact science;
 - there are large degrees of freedom in how it the formula could be applied and how each component could be defined and estimated;
- the 50 per cent discount factor would appear to involve a reasonably arbitrary judgement call of the impact of constrained property rights on the value of those rights;

²¹ Ibid.

²² Submission by Peter Gloag

- there is a range of different data sources that could be used and the quality of this data, the estimation techniques used and judgements made, can all influence the final rental calculation in different ways. The 3.05 per cent ROR is currently estimated with Residex data using Sydney median rents and median sales values. However, many stakeholders have indicated that Housing NSW data may be a more robust source.

Also, the application of the rental formula necessarily requires the use of a range of proxy inputs which are inherently imperfect since they often come from several different sources, can be compiled in different ways and often reflect value judgments.

In short, there are a wide range of outcomes that could result from the many possible reasonable choices for the application of the formula.

3.4.3 General principles for assessing the setting of a government fee

Effective policy, particularly as it relates to setting fees and payments for government services, is typically based on a consideration of three key principles, these being:

- **Efficiency:** that may be broadly defined as an outcome that maximises the net benefits for society.
- **Simplicity:** a charge that is straightforward to comply with and for the LPMA to administer. It may also provide the most transparent charge.
- **Equity:** stakeholders broadly believe that the charge is reasonable when each are paying (and the government on behalf of the community is receiving) a 'fair' amount.

These objectives tend to be competing. For example using data for waterfront properties only to calculate the ROR may be more efficient and equitable, but is likely to be more complex, and as such may not be particularly transparent. Because of the competing nature of these policy setting principles, governments often need to make judgements surrounding these criteria in making policy and pricing decisions.

In practice, the first criterion appears to have been determined under the *Crown Lands Act 1989* by the requirement to charge market rent. In light of the above subjectivity however, there would appear to be a role in applying the second and third criteria to the practical and effective setting of licence fees that reflect market rents. The principles that are likely to be consistent with achieving these outcomes are:

- consistency in application of the formula (and the variables within it);
- transparency in how charges are set;
- objectivity and independence in the sources of data and the methodologies used; and
- minimisation of transaction costs (e.g. in the form of disputation, which is likely to involve minimising price shocks where possible and broad acceptance that the fees are fair).



KPMG has prepared the recommendations based on the policy considerations of equity, efficiency and simplicity, and the supporting principles of consistency, transparency, objectivity and ensuring that the transaction costs of levying rents on domestic waterfront tenancies are minimised as discussed. KPMG acknowledges that, while our conclusions and recommendations are formed on this basis, it would be reasonable to draw alternative conclusions and recommendations, if different weights were attached to these objectives and principles.

4 Market rent

In this section we consider the definition of market rent and what might be included in the ROR to calculate market rent. Section 4.1 deals with the definition of market rent itself. Section 4.2 considers whether the method of calculating the ROR (which is an income return) is the appropriate method to use in determining market rent through the IPART formula.

4.1 Definition of market rent

Section 143 of the *Crown Lands Act* states that licence holders should be charged ‘market rent’:

143 Determination or redetermination of rent--principles

(1) In redetermining the rent of a lease or licence (the conditions of which provide for the redetermination of the rent) or determining or redetermining rent for the purposes of section 61, 62, 63 or 72 (enclosure permits), the Minister, the local land board and the Land and Environment Court shall apply the following principles:

(a) the rent shall be the market rent for the land comprised in the lease, licence or enclosure permit having regard to any restrictions, conditions or terms to which it is subject,

The Act does not specify what is meant by the term “market rent”, however, some stakeholders have expressed the view that the LPMA is not charging ‘market rent’ and that the rental formula determined by IPART does not appropriately capture this concept.

Stakeholders’ concerns appear to revolve around the period for updating the SLV and the use of a fixed ROR to determine the rent to be charged. This issue is discussed in the following section. This section explores the mechanics of what might be determined as market rent.

The NSW Department of Housing indicates on its website that “*The market rent for a public housing property is based on the rent likely to be paid for an equivalent property in the private rental market in a similar geographical location, and of a similar size and amenity.*”²³

Similarly, the NSW *Residential Tenancies Act 1987 No 26*, Section 48 notes the following with regards to the setting of market rent.

“The Consumer, Trader and Tenancy Tribunal (Tribunal) may, in determining whether or not a rent increase or rent payable under a residential tenancy agreement or a proposed residential tenancy agreement for residential premises is excessive, have regard to the general market level of rents for comparable premises (other than premises let by a government department, administrative office or public authority) in the locality or a similar locality and may also have regard to:

(a) the value of the residential premises,

²³ See NSW DOH “Calculating Market Rent - REN0040A” at <http://www.housing.nsw.gov.au/Forms+Policies+and+Fact+Sheets/Policies/Calculating+Market+Rent+-+REN0040A.htm>

- (b) the amount of any outgoings in respect of the residential premises required to be borne by the landlord under the residential tenancy agreement or proposed agreement,*
- (c) the estimated cost of any services provided by the landlord or the tenant under the residential tenancy agreement or proposed agreement,*
- (d) the value and nature of any fittings, appliances or other goods, services or facilities provided with the residential premises,*
- (e) the accommodation and amenities provided in the residential premises and the state of repair and general condition of the premises,*
- (f) any work done to the premises by or on behalf of the tenant, to which the landlord has consented, and*
- (g) any other relevant matter.”²⁴*

Broadly speaking, both of these definitions, from the Department of Housing and the *Residential Tenancy Act 1987* indicate that market rent is what would be the equivalent charge in the private rental market for a similar property. This indicates that a market rent is one that reflects current conditions in the market. The key consideration for this review is how to best capture these “current conditions” within the rental formula and, more specifically, the ROR.

At present, market rent for domestic waterfront tenancies in all precincts is determined by reference to a ROR which is based on:

- a 10-year rolling average of residential rentals; and
- residential rental data for the Sydney Statistical Division (i.e. no distinction is made between waterfront and non-waterfront properties).

In the recent NSW Auditor-General’s report that examined the performance of the LPMA and the Maritime in terms of administering domestic waterfront tenancies it was noted that

“The proposed net rate of return review should also examine the different periods over which the net rate of return and PSLVs are averaged. We observed that the current rate of return is based on a 10-year rolling average ending in 2003 for the whole of NSW and that PSLVs are determined on a three-year rolling average. A broadly based and static rate of return does not appear to represent market value for individual waterfront properties.”²⁵

Whilst it is clear from this statement that it may be appropriate to give consideration to examining RORs for different precincts and that perhaps the averaging period applied to SLVs and the ROR should be on the same time basis, no preference appears to have been expressed by the Auditor-General. This issue, along with the issue of geographic averaging, is explored further in this report.

²⁴ Section 48, Residential Tenancy Act 1987, No.26.

²⁵ See NSW Auditor-General (2009) “Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW”, p.45.

Stakeholder views

Stakeholders noted that the IPART formula attempts to calculate market rents however, “*the correct application of the IPART recommendation is not simple, nor has it been implemented correctly, with the ROR never having been reviewed, when it should have been reviewed annually to achieve market rents.*”²⁶ These stakeholders believe that the formula should be updated annually and that the time period and geography for the average SLVs for a macro precinct (PSLV) and the ROR should be the same.²⁷

In terms of the time period, these stakeholders indicated that “As the *Crown Lands Act* stipulates that ‘the market rent’ be charged, the three-year average ROR per macro precinct applied to the three-year average of SLVs per macro precinct will provide ‘the market rent’. “Nothing else will provide the correct result.”

Alternatively, these stakeholders recommended that one of three approaches should be employed to match locations. These include:

- a “whole of state” approach (providing an average rent per square metre for the whole state);
- a “whole of waterway” approach (providing an average rent per square metre per waterway); and
- a “macro-precinct” approach (providing an average rent per square metre per “macro-precinct”).

Our terms of reference are restricted to a review of the ROR and the discount factor and, as such, we are unable to make recommendations relating to the PSLVs (we cannot, for example make recommendations that the precincts or averaging period should change). This implies that, to be consistent with the above principles, we would need to adopt the “macro-precinct” approach to calculate the ROR given that the PSLVs are calculated using macro-precincts.

KPMG broadly agrees with the theoretical principles of matching the region over which the ROR and PSLVs are calculated, however we have concerns with restricting our analysis to look only at this option. This is particularly the case given that there are some data limitations, which may mean that it is more appropriate to use proxies to estimate the different elements of the formula, as is currently the case. As such, it may be necessary to use data from different geographical markets, sources or periods to estimate market rent.

²⁶ Several submissions based on WAG chain letter.

²⁷ One stakeholder noted that “Government services should not be provided at a profit, this is an abuse of monopoly power” (Submission by Margaret Colwell). The IPART formula is intended to be used to calculate market rent, which is effectively that which would be charged in a competitive market. In a competitive market, all entities need to earn some profit to survive long-term. This is no different to government services, in which a small profit is normally allowable, even at least to cover the cost of capital.

Finally, a few stakeholders mentioned that a market assessment of individual properties should be undertaken every three years to determine the market rent. We note that the Valuer-General does undertake yearly valuations of properties that include the Crown land in question.

4.2 Income only return

The ROR currently used in the formula set by IPART is effectively an income-only yield, that is, it does not include capital gains. The management of Crown land by the LPMA is subject to the requirements of the *Crown Lands Act 1989*. The *Crown Lands Act 1989* requires, among other things, that regard is to be had to “*any additional value which, because of the lease, licence or enclosure permit, has accrued, or may reasonably be expected to accrue, to other land held by the holder*” (emphasis added) in re-determining the rent of a lease or licence on Crown land. Therefore, whilst there is no justification for reflecting a capital gain on waterfront tenancies, as the underlying land is owned by the Crown, the wording of the Act raises the question as to whether it is appropriate to restrict the definition of the ROR to an income only yield, as is currently the case, or to also allow for capital gains that may accrue to the adjoining freehold property as a result of obtaining a licence to use the Crown land in question.

One interpretation of this, is that in principle, there is some scope for the rental formula to include the additional value on the adjoining freehold property that has or could be expected to accrue to the rights holder, brought about by the ability to utilise waterfront public land (i.e. the capital gain on the adjoining freehold land).

Stakeholder comments

Stakeholders were not supportive of including any other elements in the ROR. Stakeholders pointed to valuation experts’ opinions indicating that the ROR is only concerned with an income return. Capital gains (or capital losses) are irrelevant to setting the ROR. They also indicated that IPART did not consider capital gains and that it should not be considered as part of this review.

These stakeholders made the claim that the capital gains can only be realised when the property is sold. They also indicate that it would be impractical because it would vary from property to property, depending on various factors including the rental charged on the occupancy.

However, other stakeholders indicated that since the SLVs are updated regularly, a capital gain (or loss) component is incorporated into the formula as land values rise (or fall). Hence, nothing else should be included in the ROR. SLVs already include the value of the licence, not just the adjoining freehold. Accordingly, in arriving at an SLV based on the value of adjoining property, the Valuer-General has already taken account of the related licences to reach that figure.

KPMG met with members of the Valuation Services Unit of the LPMA, who are the key advisers to the Valuer-General, to discuss how they value domestic waterfront properties that have licences to use adjoining Crown land. A simplified version of the process, which is in line with the process the Valuer-General uses to value all properties, is as follows:

- the valuers observe sale price data for properties that have licences to use Crown land;

- this price is discounted to remove the value that accrues to the land as a result of the building of structures on the land, in order to establish the unimproved value of the land; and
- hence the value of a domestic freehold waterfront property is the value of the unimproved freehold land plus the additional value of the unimproved Crown land that accrues to the freehold land owner as a result of the licence.²⁸

This would appear to be consistent with the view of the last stakeholder comments mentioned. That is, the additional value of the freehold property is included in the SLVs and, as such, capital gains is included in the PSLVs. Therefore it seems reasonable to assume that the RoR applied to the PSLV will derive a market rent that takes into account unrealised capital gains and losses to the extent that they are included in the market valuation. Given this, capital gains and losses need not be considered in the ROR.

²⁸ The Valuer-General's office also indicated that all land values are updated each year, hence any change in the value of the licence is included in the updated land value of the adjoining freehold property. This would suggest that capital growth and losses are taken into account each year (as discussed earlier).

5 Rate of return

As discussed in Section 3.2, IPART set the net ROR in its general formula for calculating market rent at 3.05 per cent, which was equal to the 10-year average gross ROR on rental properties in the Sydney SD (based on data from Residex), with the average calculated over the decade to December 2003, less 2.5 percentage points which was the estimated cost of outgoings. Some stakeholders have raised concerns around the calculation of the ROR. These include:

- whether the period of averaging used to determine the ROR is consistent with determining market rent;
- the fact that the period over which the average was calculated for the ROR differs from the averaging period for the PSLVs, which the LPMA calculates as a rolling three year average;
- data used by IPART to estimate the ROR was based on the Sydney SD, even though 31 of the 54 macro precincts are located outside the Sydney SD, and 35 per cent of the number of properties with waterfront licences are in these regions;
- the ROR is estimated based on all properties in the Sydney SD, whereas the PSLVs are based on only waterfront properties in each precinct; and
- IPART highlighted in its review that the ROR should be updated ‘regularly’ but did not specify a timeframe.

This section covers the potential data sources, the appropriate time horizon over which rents are calculated, the most appropriate geographic area over which the ROR should be calculated, the frequency with which the ROR should be updated, and finally how the net rent should be calculated and what the outgoings should include.

The key conclusions from our analysis in this section include:

- the data sources should be changed to Housing NSW data;
- the ROR should be based on a three-year average (for the three years to the June quarter), consistent with PSLVs;
- the ROR should continue to be based on the Sydney SD;
- the rents for 2010 should be based on the IPART formula, but rent could change by Sydney CPI between now and the next review or updated each year through use of the formula;
- outgoings would be around 1 per cent; and
- the LPMA could recover its administration costs (estimated by the LPMA as \$1.7 million) each year through a \$250 flat fee per property or by adding 0.84 percentage points to the rate of return.²⁹

²⁹ See Section 5.6.2 for more detail on how this figure of 0.84 per cent is calculated.

Table 5.1 provides a summary of the estimated 10 and three-year average net ROR and the current IPART based ROR (using data to the June quarter 2009), assuming a 50 per cent discount factor.

Table 5.1 Impact of different options on the rate of return

	Three-year rolling average ROR, two part tariff, 2009	Three-year rolling average ROR, LPMA outgoings in ROR, 2009	IPART ROR
Gross rate of return	3.74%	3.74%	5.55%
Residential property outgoings	(1.00)%	(1.00)%	(2.50)%
LPMA outgoings*	\$250 per licence not included in the ROR	0.84%	0.00%
Net rate of return**	2.74%	3.58%	3.05%

* See Section 5.6.2 for more information on how the 0.84 per cent figure is calculated.

** Rate of return is calculated using data for the three years to June 2009

Source: Housing NSW; IPART; LPMA; KPMG estimates

5.1 Data sources

In order to calculate a market ROR (which is used as a proxy to calculate the rental charge for waterfront tenancies on Crown land), data on rent and house prices is required.³⁰ The data used by IPART in its initial estimates of the ROR was sourced from Residex, a property data company which collects information from Government Departments and Real Estate Agencies and publishes these data in reports that can be purchased.³¹

An alternative source of data is from Housing NSW, which publishes quarterly rent and sales reports based on rental data derived from information provided on rental bond lodgement forms, and sales data from information provided on the 'Notice of Sale or Transfer of Land' form that is lodged with the Land and Property Information NSW at the Department of Lands.³²

Some stakeholders have expressed concern at the quality of the Residex data used by IPART, in particular, in their responses to the recent *Issues Paper*, stakeholders have stated that:

*"The Residex data is unreliable and flawed. The Department of Housing (Housing NSW) data is the most reliable and is cheaply available in a convenient form."*³³

"The source of the rental data should be empirical studies of actual waterfront properties that have the licence attached. In my personal experience, the gross rental return on a waterfront

³⁰ It is important to note that the IPART report did not specify its data sources nor provide information on what precinct(s) had been referred to. However, in its response to questions raised by stakeholders over their fluctuating rentals and concerns over the fact that the ROR had not been updated, IPART provided stakeholders with a report by the Centre for International Economics, which had been prepared for IPART at the time of the review. This report was based on data purchased from Residex Pty Limited on 11 February 2004, and the returns were based on a rolling average of rental returns for Sydney houses for the previous 10 calendar years (1994 to 2003). See The Centre for International Economics (2004) Review of domestic waterfront tenancies in NSW, prepared for the Independent Pricing and Regulatory Tribunal.

³¹ See <http://www.residex.com.au/index.php?content=home&from=lhsmenu>

³² See for example Housing New South Wales (2009) Rent and Sales Report No. 88. Available from: <http://www.housing.nsw.gov.au/NR/rdonlyres/76053533-0992-4487-837B-3FFA2BDB2BFA/0/RSRReport88.pdf>

³³ Several submissions based on WAG chain letter.

property is around 1% not 3 or 4 % or even half of that. Should do a property market study using actual rentals or a consensus from reputable agents.”³⁴

“DOH the best, easy and simply to match the median house prices with rentals in particular postcode areas to calculate a median gross rate of return on either a “macro-precinct” basis, a waterway area basis or a whole of state basis. ...a property market study using actual rentals or a consensus from reputable agents (should be performed).”³⁵

“Both sources [Housing NSW and Residex] use Sales Data from the Land and Property Management Authority (LPMA) and that information is derived from the ‘Notice of Sale’ (NOS). Due to delays in submission of NOS HNSW do not publish data on sales until approximately 4.5 months after the end of the quarter to which the data relates. The data for the IPART report was purchased by CIE³⁶ on 11 February 2004 and included sales up to and including 31 December 2003 i.e. 6 weeks from the end of the quarter.”³⁷

Moreover, the submission by the Waterfront Action Group noted the following problems with the data used and analysis undertaken by the Centre for International Economics (CIE) from Residex, as well as the application of the recommendations to the IPART report:

- the 10-year rolling average was calculated as an average of the December quarter ROR for each of the 10-years to December 2003, rather than the rolling average of the monthly rates of return over the same period;
- Residex data is frequently revised, with significant revisions over time, for example the December 2003 ROR was initially quoted in the December 2003 report as 3.49 per cent, though by the December 2008 quarter this had been revised down by 0.44 percentage points to 3.05 per cent; and
- the CIE report recommended using a five-year rolling average ROR, less 3 percentage points to account for outgoings and, as such, recommended that the net ROR be set at 1.75 per cent, while IPART chose a 10-year rolling average and an estimate of outgoings at 2.5 percentage points.

We have examined the median rental price and rental return data for houses in the Sydney region using Residex and Housing NSW data in order to assess the quality of the different data sources. Our analysis is contained in Appendix F. Our analysis confirms that, whilst the overall trend in the rental data from the two sources is consistent across time, rental data from Residex:

- is higher than rental data from Housing NSW; and
- exhibits more volatility.

³⁴ Submission by David Nott

³⁵ Submission by David Nott

³⁶ The submission included the following endnote “This report was supplied under Freedom of Information by IPART as the source of their information”. Waterfront Action Group (2009) Fact Sheet: Data Source Comparison, submission in response to Issues Paper

³⁷ Waterfront Action Group (2009), Fact Sheet: Data Source Comparison, submission in response to Issues Paper

Given these differences, and the fact that Housing NSW data is more readily available, our analysis suggests that there is a strong case to switch to using Housing NSW data in calculating the ROR. However, as the data currently published online by Housing NSW does not line up exactly with the data published on house sales it would be useful for the LPMA and Housing NSW to work together to ensure that the relevant data is made publicly available, in order to allow for individuals to replicate the calculations of the LPMA in determining the rents on domestic waterfront tenancies.

5.2 Time horizon for calculating the rate of return

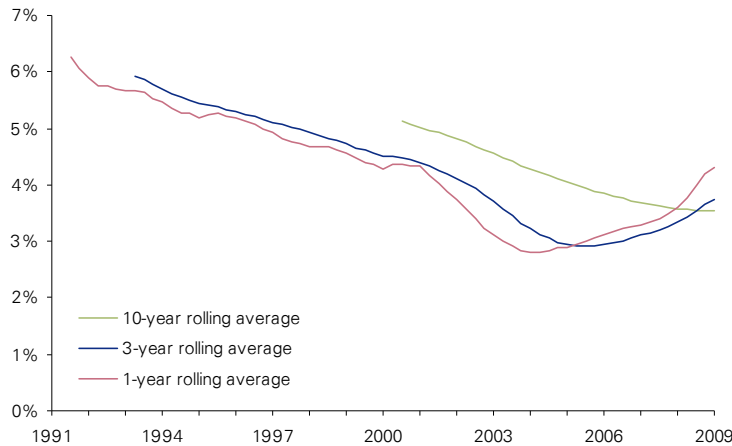
Rates of return can be calculated over different periods of time. It is necessary to consider what is an appropriate time horizon over which the ROR should be calculated since the choice of time horizons can produce varying results and have different implications for the best estimate of market rent from the IPART formula. KPMG has considered three time periods over which to calculate a ROR to meet the market rent criteria. The options include a 10-year rolling average of annual RORs which was initially used by IPART, a single year rolling average or a three-year rolling average.³⁸

IPART's use of the 10-year rolling average of residential rentals to determine the ROR in its 2004 review was justified on the basis that it was thought to provide a better indicator, as it 'smooths' year-to-year market fluctuations, and provides greater certainty to right's holders. Whilst this might be the case, a 10-year rolling average may not reflect current market rent since by definition, it takes into account rents going back 10 years. Indeed this is the view of some stakeholders who indicated that "*the 10-year average contains information that is too old to reflect the current market.*"³⁹

³⁸ In our Issues Paper, KPMG raised the possibility of undertaking econometric forecasting using a range of parameters or indicators which are relevant to land values and rentals. In this way, the estimated ROR would be based on forward-looking perceptions of the market and may better reflect turning points. The difficulty with this approach is that economic forecasting of property values tends to be a complex exercise and forecasting errors could be common and significant. Such approaches would also not be as transparent for stakeholders going forward and may not be as easily replicable. Stakeholders made limited comment on this approach and of those that did comment none were supportive. Given this, and our view that this approach over complicates the issue and may not add any value, we do not consider this approach any further.

³⁹ Egan National Valuers (2009) "Letter to the Waterfront Action Group, concerning this review, 24 November 2009" submission provided by the Waterfront Action Group.

Graph 5.1 Ten, three and one year rolling average rates of return, Housing NSW data



Source: Housing NSW; KPMG calculations

An alternative to a multiple year rolling average is to use the calculated ROR of the previous year for the following year’s rental determination. This would involve calculating the ROR based only on the previous year’s data, rather than on an average over several past years. This approach would address stakeholders’ concerns about the currency of the data on market rents. However, the likely trade off with using more current information is that year to year volatility in calculated RORs may be higher. Some stakeholders have acknowledged that “the single year approach is too tight a time frame and it could result in large fluctuations in the ROR on a year to year basis”.⁴⁰

The final approach we considered is a three-year rolling average (using data to the June quarter). Such an approach would provide a better balance between achieving a ROR which reflects current market yields with a manageable degree of fluctuation in annual rents. The three-year timeframe would also be consistent with the LPMA’s new approach for determining PSLVs based on a three-year rolling average.⁴¹ Stakeholders have indicated a preference for this alignment in their submissions to this review. In particular, some stakeholders have indicated that “as PSLVs are based on three years, so should the ROR be. Nothing else would provide market rent.”⁴² These stakeholders point to a similar conclusion drawn by the Auditor-General and the Local Land Board of NSW based on advice from valuers. These stakeholders also believe the matching of the averaging of the ROR with PSLVs would smooth out such fluctuations.

To determine the most appropriate averaging method to use, we have examined each technique using historical data as shown below. Our detailed analysis is set out in Appendix F. Our analysis confirms that there can indeed be significant differences in rental calculations using different time horizons for averaging.

⁴⁰ Egan National Valuers (2009) “Letter to the Waterfront Action Group, concerning this review, 24 November 2009” submission provided by the Waterfront Action Group.

⁴¹ See Department of Lands (2008) “Domestic waterfront tenancies – Changes in rents” at http://www.lands.nsw.gov.au/media/lands/pdf/crown_land/brochures/DWF_fact_sheet.pdf

⁴² Egan National Valuers (2009) “Letter to the Waterfront Action Group, concerning this review, 24 November 2009” submission provided by the Waterfront Action Group.

Whilst our results suggest that the 10-year ROR, updated annually, would have possibly provided the most reasonable result (in the sense that the resulting rents exhibit lower levels of volatility when compared to the other approaches, and the level of rent is within the range of the other two methods), we are wary of concluding that this would be the best approach as the results of our analysis are very much dependent upon the specific inputs applied. For example, whilst the current 10-year average provides a result that is in between the three and single year average, in 2004 at the time of the IPART decision, the 10-year average was substantially higher. This level difference may suggest that the 10-year average can lead to unrealistic outcomes since a large range of historical data is used.

Rather, the three-year average uses more up to date data and is thus more consistent with current market conditions. Furthermore, the three-year average is consistent with the current averaging method for determining PSLVs. That said, the inherent imperfections in the data which is used to estimate different elements of the formula could mean that, in practice, aligning the time horizons for the ROR and PSLVs may not lead to outcomes that better reflect market rent.

5.3 Geographic area over which the rate of return is estimated

The general formula recommended by IPART in its 2004 review was based on a single ROR for all regions in NSW, for waterfront tenancies managed by both the LPMA and Maritime. This ROR was calculated based on data on returns on houses in the Sydney region. The motivation behind using a single Sydney-wide ROR was to ensure that the formula was simple to calculate and administer, and transparent.

The key trade-off with this approach is that a Sydney based ROR may not be appropriate for areas outside of Sydney, and a number of submissions received have expressed this view. In addition, some stakeholders believe that a broad Sydney average may not be appropriate for waterfront properties since the ROR for waterfront properties is typically lower than for non-waterfront properties. The following extract from a submission is typical of the views of stakeholders who believe that the ROR and SLVs should be location and time specific:

“Advice from property experts provided to the Audit Office was that both the net rate of return and the SLV are area and time specific.”⁴³

“Ideally the ROR should include only waterfront properties, but this is not practical, because of unavailability of data. Postcode based data is readily available from Housing NSW and is therefore more practical. But SLVs should then also be considered on a postcode basis, to achieve correct matching of data.”⁴⁴

“Statutory Land Values (SLVs) are valuations of property for a given location. This means that SLVs are location specific. Rates of Return (RORs) are also location (or area) specific and vary from one area to another. (For example, the three-year average of the ROR in Precinct 2 is 0.73%, the highest of NSW Maritime’s 7 precincts. But across the Parramatta River in Precinct 4 the ROR for the same period is 0.19%, the lowest of NSW Maritime’s 7 precincts).”⁴⁵

⁴³ Submission by Phillip James Le Geyt

⁴⁴ Several submissions based on WAG chain letter.

⁴⁵ Egan National Valuers.

In order to test whether there is a case for moving to using geographical RORs to calculate rents on waterfront tenancies, KPMG obtained data on the median rent paid on all dwellings in the macro precincts, and the median sales price for all dwellings in the precincts. The rent data was obtained from Housing NSW, while sales data was obtained from the LPMA. Our detailed analysis is set out in Appendix F. Our analysis demonstrates that rents based on a three-year rolling average by macro precinct would be somewhat lower than rents based on the current ROR of 3.05 per cent, but can be higher or lower than if a Sydney three-year ROR was used, depending on the precinct.

Whilst this analysis is interesting, there are a number of data constraints which suggest that it would not be appropriate to move at this stage to using geographical RORs (as discussed in Appendix F). Given the current data constraints, and with a view to maintain simplicity and transparency, it would appear that the Sydney SD should remain as the geographical area for averaging.

Moreover, the Sydney SD more appropriate to use as the geographic region over which to calculate the ROR as, in 2009, 64 per cent of licensees were located in this geographical area. In addition, of the licensees paying more than the minimum rental in 2009, 81 per cent were located in the Sydney SD. As such, the ROR for the Sydney SD is more appropriate than using the NSW state average as the majority of licensees for which the rental formula is used (i.e. pay more than minimum rent) are located in this region.

Even though at this stage data constraints mean it is not possible to switch to using differing RORs, it would be useful if over the next few years, the LPMA could work with Housing NSW to set up a database and collect sufficient data based on macro precincts for consideration the next time it undertakes a review. Moreover, if a macro-precinct based approach is adopted, it would be useful to also make publicly available such data on rents and sales prices for these regions on either the Housing NSW or LPMA websites (and by doing so improve transparency). Note that any switch to geographical averaging of RORs would need to be based on a reasonable check of the impacts on rents.

5.4 Frequency of updates to the rate of return

The current ROR of 3.05 per cent was set by IPART in 2004 and has been applied to calculate market rents each year since that time. Many stakeholders believe that this has led to fluctuations in their rent and possible overcharging because the ROR has not been adjusted in line with changes with rents and PSLVs.⁴⁶ The recent NSW Auditor-General's report reviewing the performance of the LPMA and Maritime in administering domestic waterfront tenancies concurred with this view based on advice supplied from property valuation experts.⁴⁷

In addition, stakeholders have noted a recent decision in the Local Land Board of NSW (File number LB 09-28), where it was found as follows:

⁴⁶ See Felbigg, B. and Altman, P. Letter to the Director General of the Department of Lands on the 27th of January 2009, from the Waterfront Action Group.

⁴⁷ "The relationship between the SLVs and the net rates of return is indicated by their movements in opposite directions – generally as property values go up and the rate of return goes down. Therefore, it is preferable that both be reviewed at the same time and for the same area." See NSW Auditor-General (2009) "Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW", p.45.

“The Board accepts the correlation between the median sale value and the median rate of return. If the sale value goes up, the rate of return reduces and vice versa. To adjust one value without the other leads to an inequity in calculations. To increase the Statutory Land Value without reducing the rate return creates a higher rent than proposed by IPART”

“Given the data now before the Board, it is of the view that the rate of return should have been adjusted every time the PSLV was adjusted”

This decision has since been appealed by the LPMA, as they and IPART do not believe that the ROR should necessarily be reduced if the sale value goes up and vice versa.

KPMG provides an analysis of this issue in Appendix F. This brief analysis shows that the relationship between the ROR and land values would appear to have been largely inverse over the last 10-years, however there were some periods within the last decade during which the relationship between the ROR and land values was only weakly inverse, and for around 18 months between 2006 and 2008, the correlation was positive. This still does not necessarily mean that yearly updates would be the answer. As indicated earlier, our focus is more on ensuring the fairness of the outputs of the rent calculations and less on maintaining in principle relationships between the inputs. In our view, choice of updating should be based on what achieves a predictable and ‘fair’ rent for all involved over time.

Given this, KPMG tested different updating options to consider their impact on the rental calculation. Appendix F contains our detailed analysis. The different updating periods we examined include one, two, three and five year periods. On balance the 10-year average updated annually and the three-year average updated every three years provide the least volatility. However, the 10-year rolling average provides a calculated rent decrease over each year of the period which would appear to be unrealistic. Furthermore, the 3-year average updated every 3 years appears to be largely based on the data in the sample period with no logical reason why it is more stable than updating every 2 or 5 years.

That said, updating the rate of return each year would include the latest market data, despite the quality of the data, and would appear to be the most appropriate option in this case. However, in the next section we analyse an alternative option that may lead to better outcomes for all concerned.

5.5 CPI based growth in rents

Another option to consider is to update the inputs to the rental formula every three years (using data to the June quarter), but increase rents each year by the change in Sydney CPI within each three-year period. The advantage of this approach is that once the level of rent is set at the start of the three-year period, the change in the rent charged each year would be more predictable. There may, however, be step changes (i.e. more substantial changes in rents when the formula is recalculated) in rent at the reset point every third year, however, as discussed below, there are mechanisms which may be used to assist in managing the impact of step changes.

This approach has some support from stakeholders. As mentioned earlier, many stakeholders have been concerned with the volatility of their rents which, to some extent, has been a result of the volatility of the PSLVs. By applying CPI to current rents, this would mean that fluctuations

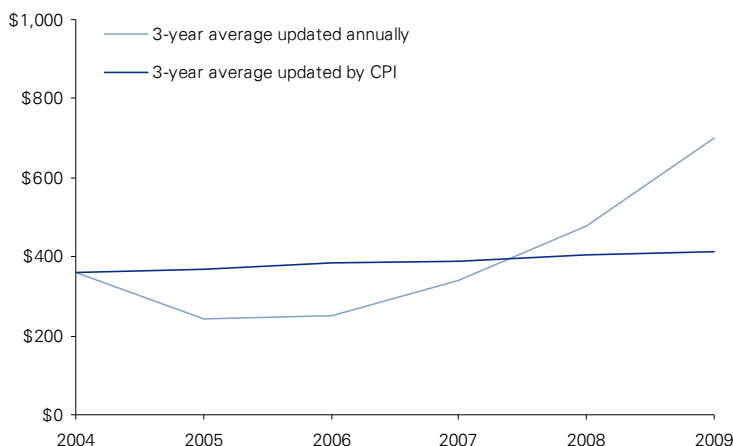
in the rent charge would vary with the average price fluctuations in the market. The Reserve Bank of Australia (RBA) has a mandate to maintain Australia's inflation rate to between two and three per cent over an economic cycle. This would mean that there is a reasonable likelihood that growth in rents can be expected to fluctuate within these bands over time (or slightly outside if Sydney CPI is significantly different to the Australian average).

Graph 5.2 compares the variation in rent based on a three-year rolling average ROR (for the period to the June quarter) had it grown by CPI, compared to if the ROR had been updated annually in the June quarter, these being:

- the PSLV is taken to be \$1,000 in 2004, and then is updated by using the annual growth in the three-year average median sales price in the Sydney SD;
- an occupancy area of 200 square metres;
- outgoings are kept at 2.5 percentage points at this stage; and
- inflation adjustments are made based on the change in the Sydney CPI series for the year to the June quarter.

This shows that had the three-year ROR been used from June 2004 and updated annually (in the June quarter), rents would have declined in the first year, before increasing from 2005 onwards. This reflects the increase in the ROR from 2005 onwards, prior to which RORs had been falling for some time. By contrast, the three-year ROR series which is updated annually by CPI, shows a much smoother upward trend. Indeed, the average annual growth in rents based on the ROR being updated annually would have been 14.2 per cent over the five years to 2009, compared with an average annual increase of 2.7 per cent if rents were set in 2004 then adjusted annually in line with CPI.

Graph 5.2 Estimated rents based on different updating methods using three-year ROR



*Note: Based on assumption of outgoings at 2.5 per cent
Source: Housing NSW; LPMA*

Nonetheless, some stakeholders may still have concerns with this approach. The first is that, if the initial calculation of rent leads to a result that is perceived to be too high, there is no mechanism to adjust rents until the next rent review. Secondly, when the rent is recalculated

with the formula after the three year period, it is possible that the rent could be subject to a step change like the methodologies discussed in the previous section. However, there are methods to address such issues. Firstly, the use of a three-year averaging process for PSLVs and the ROR ensure that the impact of any outliers years is minimised. Secondly, LPMA could employ a smoothing methodology, that phases in the impact of any step changes in rent over the next review period (e.g. a 15 per cent rise in rent may be phased in over three years). When setting prices for customers of regulated utilities, regulators will often use such an approach.

Given the above analysis, it would appear that at a minimum three-year average ROR would be appropriate because it matches the time periods for PSLVs and the ROR and it uses more recent data which would appear to be, at least in theory, more closely aligned to market rent. Indexing growth in rents to CPI also has the advantage of ensuring all rents grow in line with inflation, which is consistent with observed evidence on annual rent increases in other rental markets, and is likely to assist in managing volatility in rents. That said we recognise that this approach could be subject to step changes that would need to be managed.

5.6 Calculating net rent

The ROR is intended to reflect the net rent that the community requires as a return on waterfront occupancies. The ROR used by IPART is a net return which has been calculated:

- using the gross return for residential properties as a proxy for the ROR on Crown land; and
- subtracting the outgoings that residential property owners are responsible for covering with part of their rent – including council rates, water, repairs and maintenance, property management fees, depreciation, insurance and strata fees – as these costs are not incurred by the LPMA in managing the waterfront tenancies on Crown land.

In its 2004 review, IPART indicated that the outgoings on a standard residential property were 2-3 percentage points, and so they adjusted the gross ROR by subtracting 2.5 percentage points (equal to the midpoint of the range).⁴⁸

This section considers the estimates of the outgoings, what they comprise, and how these are calculated. It also examines the question of whether an allowance for the LPMA's outgoings should be included in the ROR.

5.6.1 Components included in outgoings

The estimate for outgoings used in the IPART review was not clear as to which components were included in the 2–3 per cent estimate of outgoings. We are therefore unable to express any view on the veracity of this estimate.

For the purposes of our review, we have reverted to first principles analysis to determine a standard set of costs that are typically incurred by a residential property owner.

⁴⁸ It is important to note that there is no clear information available to indicate where IPART obtained the estimate of the cost of outgoings at 2 to 3 per cent. IPART (2004) Review into Rentals for Waterfront Tenancies on Crown land in NSW, p.21. Available from <http://www.ipart.nsw.gov.au/files/S9-10.pdf>

KPMG Real Estate advisors have highlighted that, when calculating a net rental return for this asset class in particular, there are typically seven main components that are included, these being:

- council rates;
- land tax;
- water rates;
- building insurance;
- repairs and maintenance;
- property management fees paid to an agent; and
- an allowance for vacancy rates.

A number of stakeholders have made comments about the components that should be included in the outgoings. The Waterfront Action Group (WAG) recently enlisted the services of Egan National Valuers (NSW) to review elements of IPART's general formula, including components of outgoings. The report indicated that, in addition to the above factors, an allowance for a leasing up fee and an allowance for the depreciation of buildings, plant, equipment and contents should be included.

KPMG Real Estate Advisors and Lunney Watt & Associates who provided property valuation advice to the LPMA do not consider it reasonable, or indeed standard industry practice, to include a leasing up fee or depreciation in the outgoings of residential property owners. Specifically, KPMG Real Estate Advisors indicate that it is not reasonable to include these components to calculate outgoings for single residential holdings for the following reasons:

- **Leasing up fee:** is not included as it is only required to be paid if the property is empty, and is equivalent to one week of rental. It is a standard consideration for analysing the outgoings for multiple holdings, but not for a single residential holding.
- **Depreciation:** it would not appear to be a relevant expense for residential property owners, because it relates to capital and primarily to tax considerations, from a property investor's point of view. Typically, depreciation is only considered when it is used as a marketing tool for new developments to illustrate the depreciation benefits.

As such, on these bases, KPMG does not consider it appropriate to include these components in calculating the outgoings for a single residential property.

The Egan National Valuers report estimated the outgoings (including the additional components) based on each of the Pittwater macro precincts, using data on the median sales price in 2007 and estimates of the outgoings. It is important to note that property values in Pittwater are considerably higher than the Sydney average. Specifically, in 2008, the Pittwater macro precincts had a median sales price between 70 per cent and 150 per cent higher than for

Sydney SD. As such, this means the properties would incur more land tax than a typical median Sydney house (which would typically not incur land tax as the value of the land would be under the exemption threshold).

Based on these assumptions, for the Pittwater region, Egan found the estimates of the outgoings ranged from 2.67 per cent to 2.93 per cent of the value, though when the additional components are removed, the outgoings ranged from 0.74 to 1.08 per cent.

Lunney Watt & Associates also made a submission in response to the *Issues Paper* which contained estimates of the outgoings on a sample of single dwelling residential properties which are currently being rented at or around the Sydney median rental value of \$480 a week (based on Residex data as at September 2009). In the submission, the valuer noted:

“I have not focused on a particular geographic locality but rather a range of localities throughout metropolitan Sydney. This does not include waterfront properties as the rentals payable in respect of waterfront properties are, in almost every case, well in excess of the median rental value.”⁴⁹

In addition, the valuer chose properties that were recently sold in order to ensure that the current rent could be analysed in relation to the current market value.⁵⁰ Lunney Watt & Associates found that the outgoings on the properties analysed ranged from 0.63 per cent to 1.20 per cent, with an average of 1.01 per cent of the property value. This is broadly consistent with the estimates made by Egan National Valuers, when the additional components of outgoings are removed.

KPMG has also estimated the current level of outgoings on a median priced residential property, based on publicly available data and estimates. In order to do so, we use:

- the weighted average council rates for properties in the Sydney SD in 2007/08, adjusted for inflation (using the Sydney CPI index);⁵¹
- residential vacancy rates for the Sydney SD (based on data purchased from the Real Estate Institute of Australia);⁵²
- land tax information from the Office of Fair Trading NSW (however, as the unimproved land value for a median priced property in the Sydney SD is below the threshold of \$360,000 in 2009, no land tax is payable);
- landlord (building) insurance estimates based on estimates from online quotes from insurance agencies;
- maintenance of \$1,500 a year (which is equivalent to the average maintenance expenses incurred on properties analysed by Lunney Watt & Associates);

⁴⁹ Lunney Watt & Associates submission.

⁵⁰ The average value of the properties analysed by Lunney Watt & Associates was \$590,134 in 2009, compared with an average value of properties analysed by Egan in the Pittwater region of \$1,230,900 in 2007.

⁵¹ Data sourced from the Department of Local Government NSW, available from:

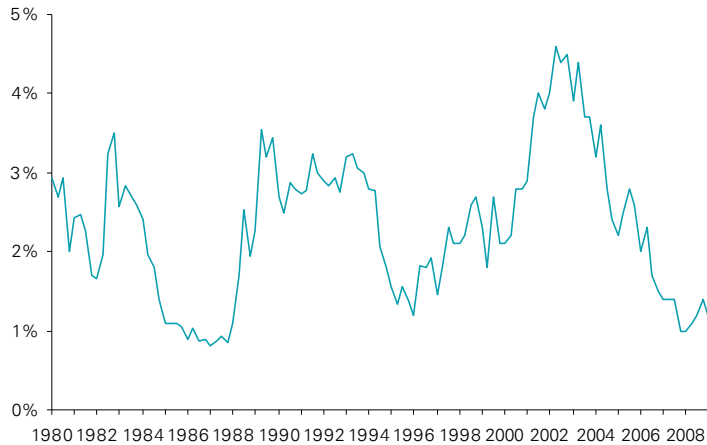
<http://www.dlg.nsw.gov.au/Files/Comparatives/0708data.xls>

⁵² Real Estate Institute of Australia, available for purchase online from: <http://www.reia.com.au/reia-ebooks-details.php?id=40>

- an assumed management fee of 5.5 per cent of gross rental; and
- water rates around \$150 a quarter.

Given this, we estimate that the outgoings would be around \$5,275 in 2009 on a median sized property, or 1.10 per cent of the value. This is comprised of around \$800 in council rates, \$600 for water, landlord (building) insurance of around \$1,000, management fees of around \$1,100, repairs and maintenance costs of \$1,500, and vacancy costs under \$300 (assuming a vacancy rate of 1.3 per cent, which is the average for the year to June 2009; see Graph 5.3). Even if a leasing up fee of one week of rent was included, the total outgoings would only be 1.18 per cent of the property value in 2009. A similar analysis has been undertaken back to 2004, which shows that outgoings range from 0.88 per cent to 1.10 per cent when the leasing up fee is excluded, and if included, the outgoings range from 0.93 per cent to 1.18 per cent.

Graph 5.3 Quarterly residential rental property vacancy rates for Sydney SD



Source: Real Estate Institute of Australia

This indicates that the 2-3 per cent estimate used by IPART is currently well above the actual outgoings incurred by residential property owners on a typical property in Sydney. The available evidence suggests that the current outgoings on a typical property in Sydney are materially less than the 2.5 estimate used by IPART. The available evidence suggests that a figure of around 1 per cent is likely to be more appropriate.

5.6.2 Recovery of Land and Property Management Authority outgoings

The LPMA does not incur the types of outgoings that are typically associated with managing a residential property (as described above). There are outgoings that are relevant to the LPMA and hence should be able to be recovered. The types of outgoings the LPMA incurs include:

- administrative costs associated with providing and managing licences; and
- costs associated with maintaining the environmental standards and general amenity value of the waterfront areas.

These costs are not accounted for in the general formula, even though the ROR is intended to deliver a net return to the community for the Crown land assets, and therefore should recover these costs.

The only way in which costs incurred by the LPMA were incorporated by IPART is through the minimum rental, which applies to licensees for which the general formula leads to a return for LPMA less than the specified threshold (\$350 in 2004). This was initially set to reflect the costs to both Maritime and the LPMA of administering the licences (as identified in a report PriceWaterhouseCoopers prepared for the then NSW Department of Lands reviewing Crown land management, licences and the operation of Crown reserves). As detailed in Section E.1, nearly half of all licence holders currently fall into this category. The implication of this is that the LPMA, on behalf of the NSW Government, may not actually receive the full ROR on the Crown land it manages for any of the tenancies.

Some stakeholders have suggested that they should not have to pay for the administrative costs that the LPMA incurs, stating that:

“Land tax is paid on the area beneath the jetty which is a separate charge, land tax alone should cover the administration charges.”

“LPMA should not be able to recover administrative costs, dealt with by IPART in the setting of the minimum rent \$350 up to \$450 now. All other costs should be reclaimed within the rental formula. To vary the formula to obtain more rental to cover administration costs, would move away from a market based formula and therefore contradict both the IPART report and the Crown Lands Act which states that rent for Crown land should be the “market rent.”⁵³

However, from the perspective of the NSW Government, who acts on behalf of the broader community, it appears that there is a reasonably strong case for including the outgoings the LPMA incurs, which covers the costs of administering the licences and maintaining the Crown land. This is in order to ensure that the NSW Government, and the broader community, are able to achieve a reasonable market return on its assets, which is over and above the administrative costs.

Stakeholders have expressed opinions in regards to the LPMA recovering the costs associated with environmental management.⁵⁴ In particular, one submission stated that:

“Variation of outgoings should only occur on a as needs basis, i.e. to maintain the integrity of the rented land may need regular dredging or weed control.”

“The costs of the environmental standard and general amenity value of the waterfront areas should not be imposed solely on the owners of the jetties.”

“Charges should be transparent and strictly related to the use of jetties for which rent is paid. The rent should not be used for general environmental or community benefits which are not specifically related to Jetty land.”⁵⁵

⁵³ Submission by James B Whitelaw

⁵⁴ Some stakeholders have indicated that the licence holders incurs the costs to maintain the environment and not the LPMA.

⁵⁵ Submission by James B Whitelaw

In addition, many licensees have pointed to the costs they incur in managing the environmental quality of the occupancy and that these are likely to increase with global warming and rising sea levels, with one stakeholder stating that:

“The cost of holding and maintaining a waterfront property is very high. The impact of salt filled winds and the tides cannot be underestimated. No allowance for this is currently made in the percentage allowed. In my case, I had to re clad the sea wall at great expense to protect the property from sea damage.”⁵⁶

This implies that the environmental costs of these properties are actually incurred by the property owners and not the LPMA. Thus there would appear to be a strong case not to include any environmental management costs as part of the LPMA's outgoings. However, there would appear to be a strong case for administration costs to be included so that the government can recover these costs.

LPMA administration cost recovery

The LPMA has advised KPMG that their current costs for administering domestic waterfront licences is \$1.7 million a year.⁵⁷ This equates to a cost of appropriately \$250 per licence, or around 0.84 per cent of the value of the LPMA's waterfront asset holdings. The value of the LPMA's asset holdings was equal to \$202.8 million in 2009, based on the following calculation:

$$\text{LPMA Waterfront Assets} = \sum_{i=1}^{6788} (\text{PSLV}_i \times \text{Occupancy}_i \times 50\%)$$

That is, the total value of the waterfront assets held by the LPMA is equal to the PSLV multiplied by the occupancy area for each property, multiplied by the 50 per cent discount factor, and summed across the entire portfolio (this being 6,788 properties). Dividing the total administrative costs of \$1.7 million by the total value of the LPMA's waterfront assets, which is equal to \$202.8 million, gives 0.84 per cent.

The LPMA has indicated that these administrative costs are associated with meeting the following policy objectives in respect of the development and licensing of domestic waterfront facilities on Crown land:

- a Crown waterfront land and submerged Crown land will remain in public ownership for long term public benefit.
- b Public access to Crown waterfront land and submerged Crown land is facilitated and maximized and domestic waterfront facilities are not to obstruct, restrict or discourage existing and future safe and practical public access along and adjacent to this land.
- c Domestic waterfront facilities will not adversely impact on the natural environment, including the natural flow of the waterway, water quality, marine vegetation and the effect of natural coastal processes.

⁵⁶ Submission by David Nott

⁵⁷ KPMG has not reviewed these costs and, as such, we have no view on the level of those costs.

- d Shared domestic waterfront facilities are encouraged where it is appropriate or necessary to minimise the number of structures on Crown land and reduce cumulative impact.
- e Domestic waterfront facilities on Crown land must be for water dependant or water related recreational purposes that require location in or in close proximity to the waterway.
- f Sublicensing of approved berthing areas to third parties is subject to Minister’s consent.
- g The location and design of the domestic waterfront facility is to harmonise with the appearance and scale of the landscape and is to maintain the visual quality of the surrounding foreshore and waterway environment.
- h Domestic waterfront facilities will not adversely impact on the cultural environment and any existing structures and localities of cultural heritage importance are recognised.
- i Annual rentals are charged for the use and occupation of domestic waterfront facilities on Crown land as a return to the State for the use of this public asset⁵⁸.

KPMG has not reviewed these costs and, as such, we have no view on the level of those costs. Rather, KPMG has considered two methods to recover these costs, which are presented below.

Option 1: Two part tariff

Under this scenario, licence holders would be charged a fixed fee for their administration costs of \$250, and a return to the LPMA which is calculated using the IPART general formula. Under this scenario, the assumption is that the administration costs do not vary with the value and/or area of the property. The formula would be as follows:

$\text{General Rent (\$)} = \text{Administration charge} + [\text{PSLV} \times \text{Area} \times \text{net ROR} \times 50\%]$
--

Option 2: Administration charge included in the ROR

Under this scenario, rents would be calculated using only the IPART formula. For the LPMA to collect the \$1.7 million a year in administrative costs, the ROR would need to increase by 0.84 percentage points to 3.58 per cent in 2009 (using the rolling average ROR for the three years to the June quarter of 2009, which was 2.74 per cent). Note that 0.84 per cent is equivalent to the total administrative costs incurred by the LPMA divided by the current value of all waterfront properties that the LPMA manages, which is around \$200 million. The formula would be as follows:

$\text{General Rent (\$)} = \text{PSLV} \times \text{Area} \times [\text{Net ROR (2.75\%)} + \text{Administration charge (0.84\%)}] \times 50\%$
--

Under this scenario, administration costs vary with the value of properties with the range of administration costs recovered from licence holders ranging from \$1 to \$6,882, with the median

⁵⁸ See LPMA 2009, Domestic Waterfront Facility Policy.

administration charge at \$128. However, the total amount collected by the LPMA would be the same as Option 1, at \$1.7 million a year.

Under both scenarios minimum rent would need to be abolished. In the event that it was not, the administration costs recovered by the LPMA would be larger than \$1.7 million a year.

These options are presented for the LPMA to consider. However, if the LPMA decides not to recover the full \$1.7 million then it could provide a discount to either the flat fee (\$250) or size of the increase in the ROR (0.84 per cent). For example, if the LPMA only increased the ROR by 0.31 percentage points, such that the ROR was 3.05 per cent in 2009 (its current level), the total amount of administrative costs recovered would be approximately \$627,000 or 37 per cent of the LPMA's estimated administration costs.

5.7 Summary of recommendations

KPMG has made the following recommendations on elements of the IPART formula:

- **Data sources:** the data source for estimating the ROR should change to Housing NSW data, as it would appear to be a less volatile data source.
- **Geographical averaging:** the Sydney SD should remain as the geographical area for averaging given that the majority of licensees for which the rental formula is used (i.e. pay more than minimum rent) are located in this region. Moreover, the quality of the data to determine macro precinct based rates of return would appear to be insufficient for use at this time. In the meantime, the LPMA could work with Housing NSW to set up a database and collect sufficient data based on macro precincts for consideration at the next time it undertakes a review.
- **Time horizon and frequency of updating the rate of return:** three options are worthy of consideration.
 - **Option A:** three-year rolling average ROR (using data to the June quarter), updated each year;
 - **Option B:** 10-year rolling average ROR (using data to the June quarter), updated each year; or
 - **Option C:** three-year average ROR (based on data to the June quarter), with rent each year increased by the CPI for the Sydney region (based on data from the ABS) and the rental formula recalculated every three years

Of the three options, Options A and C would be the most appropriate. Both Options match the time periods for PSLVs and the ROR and use more recent data which would appear to be more consistent with the concept of market rent. Option C has the advantage of increasing in line with inflation, which is consistent with observed evidence for annual rent increases in other rental markets, and also has the advantage of managing the volatility in rents. However, Option C could be subject to step changes (i.e. large increases in the year the rental formula is recalculated), unlike Option A where the rental formula is recalculated each year.

- **Net rate of return:** the estimate of outgoings should be revised to more accurately reflect current market conditions. The available evidence would appear to support an outgoings figure of 1.0 per cent.
- **LPMA outgoings:** should be included in the ROR. The LPMA have indicated that their current outgoings are approximately \$1.7 million per annum.⁵⁹ The LPMA has two main options to recover their outgoings, which are:
 - charging each licensee a flat administration fee of \$250, in addition to the rent as calculated using the general rental formula; or
 - adding 0.84 per cent to the net rate of return (which is the percentage required to recover \$1.7 million in administrative costs).

Both options would allow the LMPA to recover \$1.7 million, based on 2009 data. However each would have different distributional impacts, with the first option requiring all licensees to pay the same share of administration costs, and under the second option the share of administration costs paid would be linked to the PSLV and occupancy area. Under both options, the minimum rent would need to be abolished otherwise more than \$1.7 million would be recovered in administration costs.

Table 5.2 Impact of different options on the rate of return

	Three-year rolling average ROR, two part tariff, 2009	Three-year rolling average ROR, LPMA outgoings in ROR, 2009	IPART ROR
Gross rate of return	3.74%	3.74%	5.55%
Residential property outgoings	(1.00)%	(1.00)%	(2.50)%
LPMA outgoings	\$250 per licence not included in the ROR	0.84%	0.00%
Net rate of return	2.74%	3.58%	3.05%

* See Section 5.6.2 for more information on how the 0.84 per cent figure is calculated.

** Rate of return is calculated using data for the three years to June 2009

Source: Housing NSW; IPART; LPMA; KPMG estimates

⁵⁹ KPMG has not reviewed these costs and, as such, we have no view on the level of those costs.

6 Discount factor

This section provides an analysis of the discount factor used in the formula. It discusses:

- what the discount factor is intended to represent;
- how the Valuer-General values the Crown land and the implications for the discount factor;
- other reasons that may be considered in applying a discount factor; and
- whether more than one discount factor should apply.

We have also commented on issues relevant to specific cases such as Waterfront Access Only (WAO) properties.

6.1 Basis for applying a discount factor

The rental formula contains a discount factor to take into account limitations on the property rights of licence holders as compared with property rights normally attaching to freehold land. The discount factor is set at 50 per cent. It therefore includes factors such as the fact that the land is partially submerged, there are limitations on the structures which may be built on the land, and access across this land must be available to the community. IPART's reasons for the discount factor are:

- much of the land in question is partially or totally submerged;
- while, theoretically, the public land could be developed to complement the adjoining freehold land and thereby achieve a value which was similar to that adjoining land, there are substantial limitations on how it can be used. Currently, it may only be used for access to the waterway and associated activities;
- the general policy for this type of public land is that it should not be sold. Indeed, the present policy is that the use of public land for public purposes should be maximised. Waterfront occupancy rights holders, therefore, have no reasonable expectation that they may own the land in the future;
- statutory planning and current policy has reinforced the requirement in the *Crown Lands Act 1989* that, where practicable, access across the land (as opposed to access to any development of the land, such as structures built on the land) must be available to the community;⁶⁰ and
- any structures upon the public land must be demolished at the end of the lease (if requested).

⁶⁰ See IPART (2004) "Review into Rentals for Waterfront Tenancies on Crown land in NSW", p.20.

Whilst IPART published this list of reasons for providing a discount factor, the final figure recommended was that already in place, 50 per cent. This in the end was a judgement call based on their analysis which also reflected the objective of keeping the formula simple.

It is important to note that, while the IPART arguments may hold for many waterfront tenancies on Crown land, there are some stakeholders that suggest a discount factor of 50 per cent may be overstated for some waterfront tenancies on Crown land. The reasons provided include:

- some of the Crown land used for these waterfront tenancies is actually reclaimed land, and many have structures including residential dwellings and swimming pools located on it; and
- the waterfront Crown land provides amenity benefits to renters, particularly when the location of the property effectively provides for exclusive use, or when located in deep water regions.

That said, some stakeholders believe that the discount factor is too low. WAG commissioned Egan National Valuers to, among other things, consider the appropriate level of the discount factor. Egan claimed that the discount factor should be partially based on IPART's reasons, but should also take into account other factors and recent developments. Egan notes the case of *Georgeski vs Owners Corporation SP49833* (2004) NSWSC 1096, which determined the public has access not only to the wetland but also to any private structures built upon that Crown wetland. Furthermore, Egan believes that other factors should be considered. These include:

- the inability to automatically transfer one's interest in the wetland;
- LPMA accepts no liability for damage caused by the wash of boats or by marine organisms or other damage emanating from its property;
- the licence 'agreement' is a one-sided document where every liability and cost accrues to the licence holder and with no concomitant obligation on the part of LPMA; and
- the licence does not provide exclusive use as do most rental agreements.

Egan National Valuers does not have any evidence supporting a specific discount factor, but believes a discount rate in excess of 50 per cent would be reasonable and has proposed that a discount factor of 85 per cent would be appropriate.

Several other stakeholders that have submitted a standard letter on the issues paper also quote the aforementioned case and believe that IPART's 50 per cent discount is insufficient. However, these stakeholders suggest a lower discount of 75 per cent (i.e. the Discount Factor multiplier used in the formula should become 25 per cent, as they put it), compared to Egan National Valuers.

Others have also indicated that the discount factor is too high and should be lower if the same factor is to be applied universally. They noted that:

- the landholder, as a member of the public, has a right to use the public land;

- LPMA accepts no liability for damage caused by the wash of boats or by marine organisms or other damage emanating from its property; and
- the licence ‘agreement’ appears to be a one-sided document where every liability and cost accrues to the licence holder and with no concomitant obligation on the part of LPMA.

The licence does not provide exclusive use as most rental agreements do.

All these arguments, whilst valid considerations, relate to the value of the Crown land. The valuation of this land is undertaken by the Valuer-General each year, in conjunction with its valuation of adjoining freehold properties. As such, to obtain a better understanding of how this value is obtained, KPMG consulted with the Valuer-General.

6.2 Valuer-General process in obtaining Statutory Land Values

KPMG met with members of the Valuation Services Unit of the LPMA, who are the key advisers to the Valuer-General, to discuss how they value domestic waterfront properties that have licences to use adjoining Crown land. A simplified version of the process, which is in line with the process the Valuer-General uses to value all properties, is as follows:

- the valuers observe sale price data for properties that have licences to use Crown land;
- this price is discounted to remove the value that accrues to the land as a result of the building of structures on the land, in order to establish the unimproved value of the land; and
- hence the value of a domestic freehold waterfront property is the value of the unimproved freehold land plus the additional value of the unimproved Crown land that accrues to the freehold land owner as a result of the licence.

It seems reasonable to assume those values would reflect the net impact of the value of licence to use Crown land, less the net present value of the licence fees. In other words, if the licence fees truly reflect market value, then the market value of the freehold property would be unaltered.

This methodology is applied to establish the land value of any freehold waterfront property that has been recently sold. For other waterfront domestic freehold property that have not been recently sold, historical sales data of properties in the same or other comparable locations is used as a starting point. Adjustments are then made to account for the specific characteristics of the property in question including the characteristics of a licenced area. For example, if the property is in an area of shallow water, there are excessive weeds or there are other factors that restrict the usefulness of the Crown land, then this is considered and the land value is adjusted to

take this into account. As such, a domestic waterfront property's specific circumstance would appear to be taken into account when it is valued.⁶¹

The valuation approach adopted by the Valuer-General suggests that, at least, some of the reasons put forward for the existence of the discount factor in the rental formula have less validity. To the extent that the Valuer-General has effectively captured these factors in assessing the value of a parcel of property, there may not appear to be a case for the same factors to also be reflected in the discount rate.

The difficulty though comes down to the difference between the price per square metre value of the adjoining freehold land and that of the Crown land. That is, if the price per square metre value of the adjoining freehold land is significantly higher than the price per square metre value of the Crown land, then rents could be biased upwards significantly. Conversely, the reverse situation may also occur. The extent that these average out across the macro precincts may suggest that, on average, the discount factor is not necessary. However, it is difficult to assess if this is the case. KPMG has received some evidence from stakeholders that show that the price per square metre value of the Crown land is significantly lower than the adjoining freehold land in some cases.⁶² However, only limited examples have been submitted (or are possibly available). In some cases the opposite may be true – particularly when the landowners obtain significant amenity value from the licence, which would imply that the discount factor is not necessary. Given the lack of substantial, comprehensive evidence, it is difficult to make a judgement.⁶³

That said, even with enough evidence it would not necessary be the case that a discount should be based on the differences in the price per square metre. As noted above, the *Crown Lands Act 1989* requires, among other things, that regard is to be had to “*any additional value which, because of the lease, licence or enclosure permit, has accrued, or may reasonably be expected to accrue, to other land held by the holder*”. This would suggest that the price per square metre of the Crown land is not appropriate to use because it would not contain any additional value accruing to the adjoining land owner. The additional value of the adjoining freehold property as a result of the licence (in price per square metre) should be added to the Crown land value.

⁶¹ The Valuer-General's office also indicated that all land values are updated each year, hence any change in the value of the licence is included in the updated land value of the adjoining freehold property. This would suggest that capital growth and losses are taken into account each year (as discussed earlier).

⁶² KPMG has received four “Notice of Valuation” letters provided by the Valuation Officer to individual stakeholders. This is private information and hence we do not reveal the individual properties or owners here.

⁶³ One stakeholder indicated that “*SLVs already include the value of the licence, not just the adjoining freehold. Accordingly, when you use the SLV based on the value of the adjoining property, the Valuer-General has already taken account of the related licences to reach that figure. This is double-dipping*”. However, in the IPART formula, the SLV is divided by the area of the freehold land plus the area of the Crown land to obtain an average price per square metre figure. This is an ‘apples-with-apples’ comparison. This figure is then multiplied by individual Crown land areas to obtain the value of Crown land for each individual property.

Box 6.1: The impact of averaging SLVs

To determine the PSLVs for use in the IPART formula, the price per square metre value of the SLVs for all domestic waterfront tenancies in the precinct are averaged across the SLVs. This means that 54 different PSLVs are calculated for use in the formula for the properties in the 54 macro precincts (previously it was 429 micro precincts).

The impact of this approach is that the unique factors of each property are to some extent averaged out. That is, the SLV for properties with unique circumstances such as if the occupancy is over shallow water where the value of the land is low, will be lower than the PSLV. Conversely, the PSLV would be lower than the SLV of higher quality land over which a licence is held, such land that is used for a swimming pool. With averaging it is inevitable that there are always some who benefit at the expense of others. This approach would appear to provide a higher weight to the policy consideration of simplicity at the expense of equity.

However, valuing properties individually may not be a feasible option due to the costs involved. Indeed, conducting individual valuations may be an expensive exercise and may create a significant administrative burden for the LPMA.⁶⁴ To the extent that these costs are higher, the LPMA would need to receive compensation. This would either need to come from taxpayers or could be passed on to licence holders through a higher rent charge associated with administrative cost recovery.

The LPMA has indicated that the macro precincts are aimed at minimising the impact of this averaging process. For example, many of the Waterfront Access Only (WAO) properties are grouped together in precincts. Where this is not the case, more specific circumstances may be able to be taken into account through applying different discount factors or providing rebates, as discussed below.

It is clear that the issue is complex and there are differing views concerning how valuable the Crown land is and how much it is utilised at the expense of the public. This does not make it easy to determine a clear discount factor that would appear to be accurate and fair. However, on balance, the analysis suggests that a discount factor would appear to be warranted, at least in some cases and there is insufficient evidence to warrant a change in either direction.

The next section considers whether or not there is merit in applying different discount factors in different situations, rather than the current uniform approach. Given the above analysis it may appear that it is unlikely that different discount factors could be applied in different situations. That said, it may still be worth exploring the application of different discount factors, if sufficient data is available.

6.3 Varying the discount factor by geographic location and type of structure

Applying a 'one size fits all' discount factor across a large variety of waterfront tenancies has been and may continue to be, a cause for concern among stakeholders. Different stakeholders have argued that they should receive a larger discount because of specific conditions. However, a property's location and the nature of its access and utilisation can all impact on the value of the Crown land. Given this, one may perceive that different stakeholders should be charged

⁶⁴ It may also increase volatility since fewer data points are used to determine the SLVs each year. This was one reason why the LPMA reduced the number of precincts from 429 to 54.

different amounts based on how much value they derive or consume at the expense of the community more broadly. This issue is explored further below.⁶⁵

One method could be to offer different discounts according to a property's location. For example, some stakeholders claim that this should be the case when the water lacks depth, has excessive weeds or has other factors which limit the use of many types of common water craft. That said, other stakeholders have indicated that *"the Discount Factor is applied to the PSLV, so that different geographic locations are already taken into account (because some PSLVs will be higher and some lower, depending on their location)."* In Section 6.3 we explained how the market conditions of each property are taken into account by the Valuer General when determining each SLVs. For each macro precinct these are averaged to obtain a PSLV for each macro precinct as explained earlier. Given this, it would appear that the geographical circumstances of the properties are taken into account with the PSLVs. Given this, we do not consider this issue any further.

Another method is to apply different discounts based on the manner in which the public land is utilised by the licence holder. For example, if a licensee builds a permanent structure on the land, such as a swimming pool, this reduces the value to the community who may have used that land more often and for other purposes. In a letter to the LPMA in January 2009, the WAG, raised the issue of whether *"mud and water in shallow water is worth more than mud and water in deep water, and leased out as moorings"* suggesting that perhaps different discount factors may need to be considered in different circumstances. Other stakeholders noted that:

*"Jetties that are in shallow water, near a low bridge and cannot accommodate large ships are paying the same rate as larger jetties."*⁶⁶

*"the current arrangement errs on the side of simplicity but fails on equity. There should be different rates based on geography and on type of use. A fee based simply on area takes no account of the affect the structure has on the public use of the public land."*⁶⁷

That said, other stakeholders did not share this view and indicated that:

*"Rent is being paid for undeveloped wetland, not for what is built on that wetland, so I/we therefore submit that the discount rate should not vary according to the structures built on the wetland. The Discount Factor is a property valuation matter and any review of it should be undertaken by expert valuers in private practice and expert valuation academics from Australian universities."*⁶⁸

"How a property has been developed in years gone by is really irrelevant to the rent as the owner has built and maintained those facilities. What the government provides is right of access/use to an area of land/water and its charges should be based purely on that area, regardless of what the holder has done with it. If the discount factor took into account any improvements then implicitly

⁶⁵ International examples concerning this issue, and the application of a discount factor more broadly, are considered in Appendix F.

⁶⁶ Several submissions based on WAG chain letter.

⁶⁷ Submission by David Nott

⁶⁸ Several submissions based on WAG chain letter.

the licence holder is paying again for his improvements. He is already doing that via the total value of his property and to charge again is doubling up.”⁶⁹

“Whether different discount rates should apply for the type of structure placed on waterfront property is not relevant to this exercise. The rent is for vacant Crown land and should not reflect the added value of any improvements built upon it at the occupant’s expense”.

From an economic perspective, the claim that different discount factors should apply based on the location and utilisation of the land is most appropriate, given that the different ways in which the land can be utilised can impact on the value of the land. This is consistent with our discussion in Section 3.4.1. The use of the discount factor is not to discriminate between the types of structure built on the land, but to adjust the rent based on the extent to which the existence of the structure impinges on the use and enjoyment of the land by the broader the public. Furthermore, this method would also be consistent with considering the relative difference between the price per square metre of different Crown land and its adjoining freehold property.⁷⁰ That said, from a practical perspective, measuring the impairment in use of the land by the community may be a difficult task. Nonetheless, we explore this issue further to determine if reasonable categories of discount can be applied.

To determine whether different discount factors should apply according to the use of the land we consider international evidence, the current structures on Crown land and how to best group these structures into categories. Our detailed analysis is set out in Appendix F.

KPMG considers that two broad categories of structures are worth considering, namely those that:

- provide boat or craft access to the water which may include jetties, wharves, pontoons, ramps, slipways and wet areas; and
- permanently take up physical parcels of land such as boatsheds, swimming enclosures, decks, landings and platforms, as opposed to just the waters edge as in the first case;

Whilst there are many other structures such as steps, reclamations, retaining walls, rock armouring, piles, walkway and driveways, we understand that most of these are in addition to the above categories and are often developed to assist the public access the Crown land. Furthermore, if structures on the Crown land are from both categories, then for simplicity, it would be easier to assume that the land be charged a rent based on the stricter of the two, being structures that permanently take up physical parcels of the land.

Discussions with the LPMA suggest that these two broad categories capture the majority of the methods in which the land is used and would appear to be logical categories.⁷¹ Within these

⁶⁹ Submission by David Nott

⁷⁰ That is, if the Crown land can and is being used for a more valuable purpose, such as a tennis court, then its price per square metre value may be more closely aligned with its adjoining free hold property, when compared to Crown land that can and is being used for lesser value purposes such as a boat ramp.

⁷¹ Some stakeholders raised concerns about rent being payable on land that was reclaimed several years ago. At times this land was reclaimed to stop foreshore erosion to protect the adjoining waterfront property and often requires ongoing maintenance. Whilst this may be the case, we understand that structures have been built on the Crown land rather than on the adjoining freehold property for this to occur, which makes them subject to a licence and rent. One

categories there is likely to be debate from stakeholders concerning their relative treatment (for example long and short jetties).⁷² An overly exhaustive list of categories would create unnecessary administrative costs and thereby fail our “simplicity” criteria. The key is trying to find that balance between the simplicity in identifying and grouping into categories (and its application) compared with improving equity concerning the different methods the land is used.

Whilst a decision may be able to be made concerning on what terms different discount factors should be applied, the size of the discount that should be applied remains unresolved. We are not aware of any data that exists to estimate these discount factors. In the absence of such data, the choice is to apply value judgment in estimating discount rates for different categories, or retain the broad approach recommended by IPART.

This analysis suggest that there would appear to be a reasonable case for applying differential discount factors. That said, in practice this would be difficult to estimate, particular given that sufficient data to estimate even a uniform discount factor is currently unavailable. It may be more appropriate to revisit this matter in a more comprehensive review. In the meantime, the LPMA should work with the Valuer-General and the associated staff to better understand the data used to calculate PSLVs. This would facilitate a better understanding of the factors impacting PSLVs and hence conclusions may be able to be drawn concerning the relative value of the Crown land and its uses with adjoining freehold property.

6.3.1 Water access only properties – a special case

KPMG received several submissions concerning water access only (WAO) properties which warrant special consideration. WAO properties, as the name suggests, are properties in which the only means to access these properties is via the water. Some stakeholders believe that, as well as IPART’s original reasons for applying a discount factor, there is an extra consideration for WAO properties, in particular:

“As well as the land being submerged, the lack of road access to these properties places further limitations on the way such public land could be developed so that it provided a return to the Government. Any such attempt at development would be subject to the same difficulties listed above. Hence this land is intrinsically likely to return less than land adjacent to a road.”⁷³

IPART recognised this special case and recommended that WAO properties be granted a \$250 rebate after calculating the rent, subject to the maintenance of the minimum rent. The LPMA adopted this recommendation and has been providing this rebate (CPI indexed) since this time. Despite this rebate, many stakeholders considered that a discount factor should also be included, as well as the rebate, for WAO.

solution offered by stakeholders would be for the LPMA to sell the Crown land to the adjoining freehold property for a small fee to resolve the issue. This is something for the LPMA and stakeholders to consider separately outside of this review.

⁷² Another example is long jetties only accessible at high tide compared to jetties in deepwater at all tides which was considered in the IPART review. It was recommended in the IPART report that when a long jetty is the only means of access to the property or is used for emergencies a discount should apply. The LPMA does not apply this long jetty discount because it is of the view that a long jetty discount may have an adverse effect of encouraging longer structures in waterways. NSW Auditor-General (2009) “Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW”, page 40.

⁷³ Submission by Paul Knight.

The Auditor-General, in its recent report, considered this issue further. The Auditor-General noted that many tenants complained of inequitable treatment because other property owners who have access via public roads on Crown land do not pay rent for the road access. In support of this they claim:

- jetties are the only practical access to their properties and are akin to driveways;
- the value of a WAO property is dependent on the jetty;
- there is no security of access as a jetty licence can be revoked or refused at the direction of the Minister;
- WAO jetties reduce the impact on the public wharf system; and
- WAO jetties are used as the only way of access by emergency services.

However, the Auditor-General also noted that there are counter arguments against this including:

- WAO properties can be accessible by boat without a jetty;
- all WAO precincts have public jetties;
- WAO properties generally are of a lower value than similar properties with road access which results in lower rent;
- the value of a WAO property increases significantly with a jetty;
- a domestic waterfront tenancy licence is only revoked when a tenant does not meet the conditions of the tenure agreement;
- owners of properties with road access pay for the road access in the purchase price of the properties;
- LPMA does not require domestic waterfront tenure holders to provide public access to their domestic waterfront structures; and
- rent for WAO can be lower if structures are shared.

Having presented these arguments, the Auditor-General did not provide an opinion as to a way forward for this issue.

As indicated, several stakeholders commented on this issue and expressed their concern. A summary of these concerns are listed below:

- for WAO properties, the ROR is lower than that for rental property in general. This is largely due to the high overheads for WAO properties, and the lack of facilities typically

available to residents. In spite of relative proximity to major centres in many cases, these properties are often less well served by all levels of Government than rural areas. The lack of facilities make the properties unattractive for rental, and the high costs further reduce ROR;

- to charge waterfront access only to property owners to access their homes is akin to charging land based people to cross footpaths (Crown land) to access their homes. Access to the waterfront is a necessity not a luxury; and
- with Island foreshores, a lot of the onus to care and upkeep of the foreshores is taken on by the licensee. The ROR should consider this and not just be an ever increasing scale.

Whilst KPMG appreciates that this may be the case, given our discussion earlier concerning our understanding of how the Valuer-General values these properties, we believe that these considerations are taken into account in the PSLVs. That is, the Valuer General uses available market data to value individual properties and adjusts this market data, based on specific circumstances, for properties with different characteristics. One stakeholder disagrees with this viewpoint.

“The precinct valuation process is intended to accommodate the variances in property values, but this does not work equitably in the case of WAO properties. The value of properties partly reflects the value of already privately installed infrastructure (water tanks, on-site sewerage treatment, solar electricity systems, emergency generator, fire-pump, jetty). This infrastructure is essential to being able to live in the properties. The cost of this infrastructure means a very modest dwelling may have a high valuation, and the ROR is low. In a road access property, this infrastructure is provided by the Government, so a high property valuation typically reflects the desirability, and thus rental value, of the property.”⁷⁴

However, buyers and sellers implicitly take the value or cost of access into account when making their own judgements about the value of a property for sale and the valuation process is based on market data, buyers and sellers implicitly take this into account when making their own judgements about the value of the property for sale. Furthermore, as mentioned, the Valuer-General uses this data as a starting point and adjusts it accordingly for the specific properties in question.

Some stakeholders have also addressed the reasons against a discount factor for WAO properties as stated in the Auditor-General’s report. These stakeholders consider that the statements made in the Auditor-General’s reports are ‘misleading’ and they would like Auditor-General’s report corrected. It is outside of KPMG’s terms of reference to recommend that the Auditor-General’s report be changed. Furthermore, we are unable to verify the statements made by either party. That said, the reasons put forward against applying a specific discount factor for WAO properties are no more compelling than the reason for applying a discount factor because the specific circumstances of WAO properties are included in the Valuer-General’s valuation of these properties.

Whilst the above rationale suggests that a discount factor is not appropriate for WAO properties, it does not necessarily support the removal of the rebate. This rebate can be viewed as a means of achieving a social policy goal of the government. Removal of the rebate could prejudice the provision of direct, easy access to WAO properties. Whilst one view may be that WAO owners

⁷⁴ Submission by Paul Knight.

are exercising their choice to live in such a property and, as such, should choose whether or not they want to pay the additional costs required, this would be a narrow perspective.

For example, in an emergency, the fact that a structure such as a jetty exists reduces the risk to the occupants and aids the efficient provision of assistance by government service providers and other. The government is making a choice that, on balance, society would prefer that these WAO owners had these structures so that help can easily be provided. This is similar to when governments provide subsidised services to rural and regional areas to ensure that they can access such services at affordable prices (such as telecommunications).

- The final two issues stakeholders have raised concerns with are the growth in the rebate over time and application of the rebate to licensees with WAO properties that are paying minimum rent. These two issues are outside of the scope of our terms of reference.

6.3.2 Other cases

In addition, several stakeholders noted their specific circumstances and that these should be taken into account. These include the impact of flooding and sea level rise that have impacted on the benefit that the public can derive from their adjoining Crown land. Others pointed to the specific conditions apparent in their licence. The IPART formula is designed so that a simplistic approach can be applied to calculate the rent payable for these waterfront properties across NSW. As such, it is unable to take into account every specific circumstance. That said, as mentioned earlier, these issues would be considered by the Valuer-General in the revaluation of each individual's property. The LPMA also provides rent concessions and hardship relief for some licence holders.⁷⁵ Specific issues should be addressed to the LPMA directly.

6.4 Summary of recommendations

In summary, given the analysis above:

- the discount factor should remain at its current level of 50 per cent;
- the single discount factor should remain for all properties;
- the value of the discount factor, and whether different discount factors should be applied, should be reconsidered in a more thorough review, potentially in during 2012 review if the LPMA is to undertake a review in conjunction with Maritime, or if the matter is referred to IPART for review;
- that LPMA work with the Valuer-General before the next review to better understand the data used to calculate the PSLVs to assist in the estimation of the discount factor and to assist in the possible estimation of different discount factors; and

⁷⁵ LPMA (2009) "Rent concessions and hardship relief", See http://www.lands.nsw.gov.au/media/lands/pdf/crown_lands/policies/Concessions_and_Hardship_Relief.pdf

- the types of issues that the LPMA could look to consider in a future review more accurately to determine the level of the discount factor may include:
 - whether the Crown land is worth more or less, on average, than the average of the adjoining freehold and the Crown land and by how much; and
 - what is the difference in the value of land based on the structures that are currently used on the land, to determine whether a different discount should be applied in different circumstances.

A Glossary

Term	Definition
Crown land	Land that is owned and managed by State Government, which includes: Crown lands held under lease, licence or permit (including waterfront Crown land); community managed reserves; lands retained in public ownership for environmental purposes; lands within the Crown public roads network; and other unallocated lands.
Crown land licence	A Crown land licence is a contractual agreement that grants the licensee a personal right to occupy and use Crown land for a particular purpose. It does not grant exclusive possession of the land, as is the case with a lease, and may permit the land to be used by other persons.
Domestic waterfront licence	Domestic waterfront licences are granted by the LPMA for the use of submerged and tidal Crown land where licence holders have direct access to Crown land.
General rent	Is the annual fee calculated through the application of the IPART formula before any discounts or rebates
Gross rental return	Median weekly rent, divided by the median sales price multiplied by 365 divided by seven
Mean high water mark	The boundary between the water and land, determined by surveyors in accordance with the Surveyor General's Directions No. 6. <i>Water as a Boundary Procedures</i> .
Net rental return	Gross rental return less the cost of outgoings.
Occupancy	The area for which a domestic waterfront tenancy on Crown land is charged.
Outgoings	Costs associated with managing and maintaining a rental property, which, on a residential dwelling, may include: <ul style="list-style-type: none"> • council rates; • water; • insurance; • property management fees; • strata fees; • repairs and maintenance; and • depreciation.
Reclamation	An area within an occupancy that was originally part of the seabed, but has been 'reclaimed' by the rights holder by raising the level of the land so it is above the high water mark.
Structures	Domestic waterfront licences generally cover facilities such as jetties, boatsheds, berthing areas, boat ramps, slipways and pontoons on foreshore Crown land adjoining waterfront properties.
Waterfront properties	Refers to residential properties that have waterfront access.
Waterfront tenancies on Crown land	Refers to the land over which domestic waterfront licences are held, this being the Crown land below the mean high water mark on which structures are built.

B Macro precinct geographical groupings

Geographical region	Macro precincts in region
Ballina	Ballina East Ballina West Richmond
Brisbane Water	Brisbane Water East Brisbane Water West
Far North Coast	Kingscliff Murwillumbah Tweed
Georges River	Georges River 1 Georges River 2 Georges River 3 Georges River – Water Access Only – 4 Georges River 5
Great Lakes Upper Hunter	Great Lakes North Arm Cove Tea Gardens Wallamba Cove
Hawkesbury River	Hawkesbury River – Water Access Only – 1 Hawkesbury River – Water Access Only – 2 Hawkesbury River 3 Hawkesbury River – Water Access Only – 4 Hawkesbury River 5
Lake Macquarie	Lake Macquarie 1 Lake Macquarie 2 Lake Macquarie 3
Mid North Coast	Greater Taree Hastings The Anchorage
North Coast	Bellingen Clarence Lower Nambucca
Port Hacking	Port Hacking 1 Port Hacking 2 Port Hacking 3
Port Stephens	Port Stephens

Geographical region	Macro precincts in region
Pittwater	Pittwater – Water Access Only Pittwater 1 Pittwater 2 Pittwater 3 Pittwater 4
South Coast	Burrill Lake Clyde River Conjola Lake Cookhaven - Shoalhaven Currumbene Creek Currarong Creek Pambula – Merimbula Tabourie Creek Tomaga – Moruya – Tuross Wagona – Wallaga Womboyn River
Tuggerah Lakes	Tuggerah Lakes

C Consultation

KPMG undertook a limited consultation process as part of this review. This involved:

- the release of an issues paper requesting comment;
- receipt of submissions from interested stakeholders; and
- face to face consultation with key stakeholders to clarify any positions and to illicit further comment.

This appendix presents the stakeholders that provided submission, presents the key stakeholders we undertook face to face consultation with and provides a brief summary of the key issues raised during the consultation process. These positions have been taken into account in the analysis and, where appropriate, reflected throughout this report.

C.1 Submissions received

KPMG receive 97 submissions from the following stakeholders.

Phillip James Le Geyt	Bruce and Margaret Colwell
Kevin Collins	Waterfront Action Group (WAG) Philip Altman, Chairman
Simon Flack	Tony Kandaiya
Danny Crowther	Hugh and Jeanine Treharne
Fraser & Sylvia MacKenzie	Peter McInerney
N Weaver	Lionel Goldberg
Colin Treweeke	John Kersey
Kennard	Brian and Tara Gulliver
Mark Orchard	David McKew
Ross Cameron	Graham Irwin
David Hall-Johnston x 2	Hal Jeske
Catherine Crawford	Tony Lotz
Rohan Walter	Paul Blackshaw
Paul Knight	



Cameron Miles	Kevin Jan
DJ Bassett	Michael Chapman
Robert M Bowerman	HA Fraser
James B Whitelaw	JB & V Sale
John and Caroline Forbes	Colin Montgomery
JR Baird	Allan Sullivan
Stephen and Karen Carroll	William and Diane Wallbank
W&ME Durkowsyk	RJ & WM Puffett
Kerry L Borg	Angus E Forbes
Jane Jacobson	Anita Doe
Wayne Rees	Mark D Thomas
Noel Doyle	Malcolm and Judith Corbett
WAG Secretary, George Citer	Robert Sturrock
Charles Gonzalez	Gregory Ross
Home Access Association	Dorothy Ranger
Carolyn and Anthony Britt	Ms Lynn Peaty
David Nott	Montague and Pamela Watkins
Ian Phillip Williamson	Graham and Rae Turnbull
Peter Gloag	Jack Lindsay
West Pittwater Community Association	Hugh and Jeanine Treharne
Peter Stitt on behalf of Owners Corporation of Strata Plan No. 3958	Mr DH Johnson and Mrs RK Johnson
ML & JA Corbett	Brigitte Donnan
Barry and Ellen Evans	Louis C Cordony
Barry and Gail Walker	Brian Whelan for the estate of late HR Toby



Tarnia and Stephen Quigley

LM Chalmers

Robert and Joyce Forbes

ER and PG Radford

Iris Yee

AR & L Davies

Graham Doust

Lesley Stevens

Greg Roberts

Peter Charlton

Rod and Jan Read

Glenn Moore

AH and ML Petrie

H&L Tasseron

Tammy Richardson

Michael Buliak

Phil Sargeant

Tom Condon

John L Thompson

C.2 Parties consulted with

KPMG undertook face to face or phone consultation with a number of key parties. These consultations were undertaken to clarify the key positions and processes of the agencies mentioned, to better understand approaches used to calculate the different elements of the IPART general formula and the reason for those approaches and to allow for further comment and clarification of the community. The following table summarises the stakeholders consulted, their roles and the issues discussed.

Party	Role	Issues discussed
LPMA	<ul style="list-style-type: none"> Agency subject to this review. 	Discussions regarding their processes, quantification methods and considerations.
Maritime Authority of NSW	<ul style="list-style-type: none"> Provide leases for domestic waterfront tenancies, predominantly in Sydney Harbour. 	<ul style="list-style-type: none"> The process they have undertaken for their review. Likely steps moving forward.
Valuation Services Unit (LPMA)	<ul style="list-style-type: none"> Key adviser to the Valuer-General's Office. 	<ul style="list-style-type: none"> Discussions concerning their processes and methods in determining land values, used for PSLVs.
IPART	<ul style="list-style-type: none"> Prepared the first report and recommended the formula to be used in calculating rent. 	<ul style="list-style-type: none"> Clarify positions and discussions regarding recommendations.
Residex	<ul style="list-style-type: none"> Key data provider for the current ROR. 	<ul style="list-style-type: none"> Definition and classification of their data.
Housing NSW	<ul style="list-style-type: none"> Alternative data supplier considered. 	<ul style="list-style-type: none"> Definition and classification of their data. Sourcing of data by macro precinct.
Waterfront Action Group (WAG)	<ul style="list-style-type: none"> Key group representing licence holders. Contributed to over 50 per cent of the submissions. 	<ul style="list-style-type: none"> Clarified position. Sought additional comment.

C.3 Issues raised during the consultation process

The following range of issues were raised in the consultation process. These have been consolidated into the different sections of the report for convenience.

C.3.1 Contextual

Many stakeholders submitted a standard letter that reflected the following contextual comments, and other stakeholders presented similar contextual views:

“I am aware of the Auditor-General’s report “Administering Domestic Waterfront Tenancies and of the following recommendation:

- *“Lands and Maritime should improve customer service by jointly reviewing the net ROR in an open and consultative manner by December 2009. The review should include assessment of the net ROR from a location and time specific perspective, similar to the approach taken for assessing the statutory land value of precincts”*
- *“Advice from property experts provided to the Audit Office was that both the net ROR and the SLV are area and time specific. The relationship between SLVs and the net ROR is indicated by their movement in opposite directions – generally as property value go up the ROR goes down. Therefore it is preferable that both are reviewed at the same time and for the same area. The proposed net rate or return review should also examine the different periods over which the net ROR and PSLVs are averaged”.*

I am also aware of a recent decision in the Local Land Board of NSW (File number LB 09-28), where it was found as follows:

- *“The Board accepts the correlation between the median sale value and the median ROR. If the sale value goes up, the ROR reduces and vice versa. To adjust one value without the other leads to an inequity in calculations. To increase the Statutory Land Value without reducing the rate return creates a higher rent than proposed by IPART”*
- *“Given the data now before the Board, it is of the view that the ROR should have been adjusted every time the PSLV was adjusted”*

I submit that the review should fully take into account the recommendations and comments of the Auditor-General and the Local Land Board, as they apply to the ROR.

Furthermore, I submit that there are fundamental valuation principles involved in determining the ROR and that the review should follow those principles, as put forward by expert valuers in private practice and expert valuation academics from Australian universities.

C.3.2 Market rent

As above, many of the stakeholders made reference to the Auditor-General’s report and a Local Land Board decision (to be appealed) indicating that the PSLVs and the ROR should be based on the same location and time basis. Options to consider included a:

- “whole of state” approach (providing an average rent per square metre for the whole state);
- “whole of waterway” approach (providing an average rent per square metre per waterway; or
- “macro-precinct” approach (providing an average rent per square metre per “macro-precinct”).

Stakeholders pointed to valuation experts opinions indicating that the ROR is only concerned with income return. Capital gains (or capital losses) were seen as irrelevant in setting the ROR. Stakeholders commented that the current increase in rents caused by the use of the adjusted SLVs certainly builds in unrealised capital gains.

C.3.3 Rate of return

Data sources

Stakeholders commented that the Residex data was unreliable and that data from the Department of Housing was more appropriate.

The use of any “land” data is quite arbitrary and the only comparable rental is the rental of moorings.

Time horizon for calculating the rate of return

Stakeholders quoted the Auditor-General’s Report and advice from property experts that indicated that the ROR should be assessed from a time and location specific perspective. As PSLVs are based on three years, so should the ROR be. Nothing else would provide market rent.

Geography

Stakeholders again referred to the Auditor-General’s Report and advice from property experts that indicated that the ROR should be assessed from a time and location specific perspective. Stakeholder supported varying the ROR by region because they note “it does.” Others indicated that the only reason the ROR is not based on geographical areas would appear to be simplicity. Some stakeholders also mentioned that ideally it should only include waterfront properties, however they acknowledge data limitations prohibit this.

Frequency of updates to the rate of return

Stakeholders again quoted the Auditor-General’s report, the Local Land Board’s decision mentioned and advice from property valuers. Stakeholders general indicated that the ROR should be updated at the same time as the PSLVs. Other opinions ranged from market assessments every three years and to updating immediately if there are movements in property values but capped to provide certainty.

Outgoings

Stakeholders expressed the following view with regards to outgoings:

- as the basis of the ROR is the rental return to a landlord of residential houses, all the outgoings incurred by such a landlord should be included;
- outgoings should be based on a percentage basis which would be the most reliable averaging method;
- a dollar value that has fixed, state or precinct wide basis could cause huge variations in the rent charged. For example, the dollar value of outgoings may be more than the rental

income in the lower valued regional areas if a fixed dollar amount was utilized on a state wide approach;

- that, based on a report prepared by Egan National Valuers, estimated outgoings are between 2.52 per cent and 2.93 per cent for certain Pittwater and Sydney Harbour precincts. The report also indicates that “given the slight difference and for administrative convenience there is a case for adopting the average percentage outgoings and apply to all precincts;”
- there needs to be an allowance for a vacancy factor;
- the percentage should be based on an empirical study. It needs to use long term averages in the same way that strata plan apartment blocks are now required to develop 10-year plans in setting the sinking fund levy;
- outgoings are likely to increase with global warming and rising sea levels;
- the LPMA sets rent as if it were a landlord but performs none of the functions of a landlord and assuming none of the risks, it only sends out invoices hence should not be able to recoup costs;
- the government should be able to recover its costs but not profit; and
- the LPMA should not be able to recover administrative costs, because this was dealt with by IPART in the setting of the minimum rent \$350 up to \$450 now. All other costs should be reclaimed within the rental formula. To vary the formula to obtain more rental to cover administration costs, would move away from a market based formula and therefore contradict both the IPART report and the *Crown Lands Act* which states that rent for Crown land should be the “market rent”.

C.3.4 Discount factor

Some stakeholders indicated that the discount factor should be reduced (leading to the payment of less rent) to accommodate new information since the IPART report. They noted:

“The discount factor should be higher because of the case of Georgeski V Owners Corporation SP49833 (2004) NSWSC 1096, which determined the public has access not only to the wetland but also to any private structures built upon that Crown wetland. Furthermore, other factors should be considered. These include:

- *the inability to automatically transfer one’s interest in the wetland;*
- *the ability of LPMA to terminate the licence at any time, requiring the licensee to demolish all structures and return the wetlands to its original state;*
- *the additional cost of building on wetland; and*
- *one can only build a very limited range of structures on the wetland.*

- *After consideration of the points above and IPART's 4 points, considers that the discount rate of 85 per cent (15 per cent) would be appropriate."*

Other reasons for reducing the discount factor, as mentioned by stakeholders, include:

- the LPMA accepts no liability for damage caused by the wash of boats or by marine organisms or other damage emanating from its property;
- the licence "agreement" is a very one-sided document where every liability and cost accrues to the licence holder and with no concomitant obligation on the part of LPMA; and
- the licence does not provide exclusive use as most rental agreements do.

However, other stakeholders did not share this view. In particular some stakeholders indicated that "the discount (50 per cent) is a fair a reasonable assessment of the diminution in its value per square metre when compared with the per metre value applied to the freehold it adjoins".

Different discounts by location

Stakeholders expressed mixed views concerning the application of different discounts for different locations, specifically:

- different discounts should apply to different locations. For example the type of water which through lack of depth, excessive weed or other factors which would limit the use of many types of common water craft; and
- discount factors should not vary between locations, this is accounted for in the statutory land value.

Different discounts by use

Stakeholders expressed mixed views concerning the application of different discounts for different locations. Those that appeared supportive of different discount factors by use indicated the following:

- jetties that are in shallow water, near a low bridge and cannot accommodate large ships are paying the same rate as larger jetties;
- the current arrangement errs on the side of simplicity but fails on equity. There should be different rates based on geography and on type of use. A fee based simply on area takes no account of the affect the structure has on the public use of the public land; and
- a more equitable system would not be based on area but on geography and use. Such a system would be no more inefficient since enormous amounts of time are currently expended on surveys to determine land area and determining statutory land values.

Stakeholders suggested that different discount factors could be applied for:

- buildings and swimming pools;
- jetties and berthing – licences of swing moorings are charged on the basis of boat length and theoretically the area of water used for mooring. This principle should be extended to jetties and berthing areas; and
- reclaimed land – reclaimed lands as constructed more than 50 years ago to stop foreshore erosion caused by natural run-off and to protect services such as community sewerage pipes. These require significant maintenance by the adjoining waterfront tenant and should not be subject to the PSLV.

Those that appeared unsupportive of different discount factors by use indicated the following:

“Rent is being paid for undeveloped wetland, not for what is built on that wetland, so I/we therefore submit that the discount rate should not vary according to the structures built on the wetland.”

“How a property has been developed in years gone by is really irrelevant to the rent as the owner has built and maintained those facilities. What the government provides is right of access/use to an area of land/water and its charges should be based purely on that area, regardless of what the holder has done with it. If the discount factor took into account any improvements then implicitly the licence holder is paying again for his improvements. He is already doing that via the total value of his property and to charge again is doubling up.”

“Whether different discount rates should apply for the type of structure placed on waterfront property is not relevant to this exercise. The rent is for vacant Crown land and should not reflect the added value of any improvements built upon it at the occupant’s expense.”

Waterfront access only (WAO)

Several stakeholders commented on the specific circumstances of Waterfront Access Only (WAO) property owners. In summary, stakeholders noted that:

- for WAO properties, the ROR is lower than that for rental property in general due to higher overheads and lack of facilities typically available to residents;
- to charge waterfront access only property owners to access their homes is akin to charging land based people to cross footpaths (crown land) to access their homes;
- with island foreshores, a lot of the onus of care and upkeep of the foreshores is taken on by the licensee. The ROR should consider this and not just be an ever increasing scale;
- the precinct valuation process is intended to accommodate the variances in property values, but this does not work equitably in the case of WAO properties. The value of properties partly reflects the value of already privately installed infrastructure (water tanks, on-site sewerage treatment, solar electricity systems, emergency generator, fire-pump, jetty). This infrastructure is essential to being able to live in the properties. The cost of this infrastructure means a very modest dwelling may have a high valuation, and the ROR is

low. In a road access property, this infrastructure is provided by the Government, so a high property valuation typically reflects the desirability, and thus rental value, of the property;

- the WAO rebate, which is indexed to inflation, has moved relatively slower compared to the adjoining freehold land;
- the Auditor-General's report stated that "*Lands provides WAO rebates of \$250. However, only 18 per cent (130) tenants with WAO receive this rebate as the rest (589) pay the statutory minimum rent;*"⁷⁶ and
- considered that the statements made in the Auditor-General's report against a discount factor are 'misleading', and expressed a desire for the Auditor-General's report to be corrected and for these issues to be considered in our report.

C.3.5 Other issues

Stakeholders also raised a number of other issues that are outside the scope of terms of reference. These issues have been summarised here and referred to the LPMA for consideration. These issues include:

- claim that concessions should be provided for retired seniors or those unemployed – similar to transport concessions;
- some licensees pay for a licence for a jetty but never use the jetty;
- the PSLV is inappropriate to use in the formula as it relates to market value including buildings, other land improvements and it may contain commercial property. This is not relevant to a jetty/berthing area or reclaimed area that simply is not saleable by the Crown;
- the occupancy area should only include that which is used by the tenant. Historical reclamations which are required to protect the foreshore or public services should be excluded;
- the market value of reclaimed land must initially be based on what could the Crown achieve by sale or rental. If the property is not saleable and therefore not rentable a nominal administration fee should be charged;
- rates charged should be comparable to other services, not just excessive increases;
- the LPMA has not applied all of IPART's recommendations;
- the boundary (the mean high water mark (MHWM)) between the freehold land and the LPMA area up for licence is quite arbitrary having been defined in the past by a number of reference points with just a "best guess" in between. Consequently some freehold land which is above the official MHWM is permanently underwater and in other cases land

⁷⁶ See NSW Auditor-General (2009) "Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW", p.25.

below the MHWL is permanently dry. Also erosion over the years coupled with isolated rulings in the Land and Environment Court have brought about official MHWL which bear little relationship to the actual tides;

- claim that the minimum annual licence fee be reduced to accommodate less expensive areas along the coast;
- suggests that GST should not be applied to the rent. Asks that Lands obtain a ruling from the ATO;
- concerns that “*a licence that is proffered for time periods that give us no guarantee on title of ownership (it may not be renewed on the whim of the minister) which impacts on our values and future retirement,*” and that this law does not exist for other landowners in NSW.

D Auditor-General's recommendations

The Auditor-General made the following recommendations for the LPMA and Maritime improve customer service.

- 1 Strengthening collaboration by agreeing on a joint approach to limit, control and reduce differences in their practices. A memorandum of understanding will ensure that:
 - reviews of practices are jointly conducted and on an agreed cycle;
 - differences in the introduction of revised practices are minimised; and
 - phasing-in practices are standardised and differences in rents are minimised.

These arrangements should be in place by December 2009.

- 2 Further improving communication with tenants by:
 - addressing tenants' issues in a more open and timely manner, including implementing processes to prioritise them and advise tenants of progress; and
 - making policies and decisions transparent, especially with rental invoices, to compensate for the limited rights of appeal.
- 3 Extend and promote the option of paying rent in instalments to all tenants by June 2010.
- 4 Introducing a systematic approach to recording and managing inquiries and complaints on domestic waterfront tenancies to ensure responses are appropriate and timely by December 2010.
- 5 Jointly reviewing the net rate of return in an open and consultative manner by December 2009. The review should include assessment of the net rate of return from a location and time specific perspective, similar to the approach taken for assessing the statutory land value of precincts.
- 6 Maritime should replace the old leases with the new leases by December 2010 to apply the rental formula to all domestic waterfront tenancies. (An exception is those long term leases that cannot be replaced until lease term has expired.)
- 7 The LPMA should:
 - ensure that the occupancy areas are included in the precinct statutory land valuation calculations, similar to Maritime by December 2009; and

- include on their website all policies on domestic waterfront tenancies and specifically information on the calculation of rent rate per precinct, similar to Maritime, by December 2009.⁷⁷

⁷⁷ NSW Auditor-General (2009) Performance Audit, Administering Domestic Waterfront Tenancies, Land and Property Management Authority and Maritime Authority of NSW, p.7. Available from: http://www.audit.nsw.gov.au/publications/reports/performance/2009/waterfronts/waterfront_tenancies.pdf

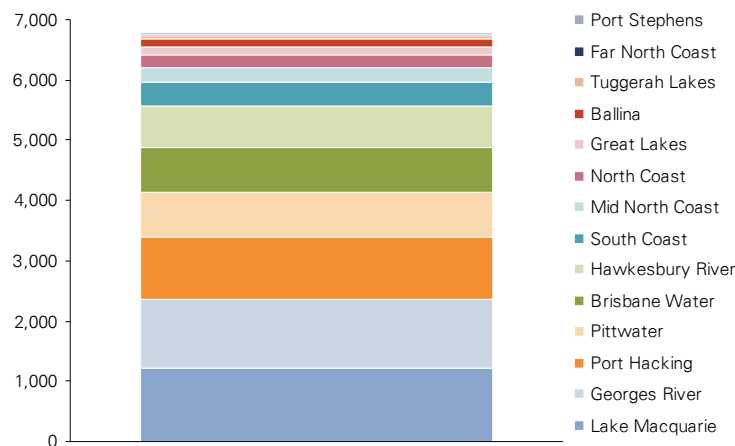
E Recent trends in fees charged by LPMA

This section details how rents paid by licensees have changed over the period since the IPART rental formula has been applied by LPMA. We review how rents have changed for licensees paying minimum rent and above minimum rent, and discuss some concerns that stakeholders have flagged in response to the *Issues Paper*.

E.1 How rents have changed over time

LPMA manages licences with over 6,700 waterfront tenancies in NSW, the majority of which are in the Lake Macquarie, Georges River, Port Hacking, Pittwater, Brisbane Water and Hawkesbury River regions (combined, these regions account for over 80 per cent of licences managed by LPMA, Graph E.1). These licences cover a total occupancy area of 750,000 square metres of Crown land, with the average occupancy in 2009 of 111 square metres. In 2009, the net revenue raised by the LPMA from waterfront tenancies was \$6.3 million, of which around 20 per cent is used to cover administrative costs.⁷⁸ As such, revenue from this source accounts for only around 3 per cent of the LPMA's revenue from customer sales, and a just over 2 per cent of the LPMA's total revenue.⁷⁹

Graph E.1 Licences managed by the LPMA



Source: LPMA

The median rent paid by all licence holders in 2009 was \$419, which was just over the minimum rental of \$400, though the average was \$929. In per square metre terms, the median rent in 2009 was \$9.72 per square metre of occupancy. Just under a quarter of all tenants were paying over \$1,000 a year in rent, while 48 per cent of licensees were paying the minimum rent. The share of licensees that pay the minimum rental varies by region, with only 4 per cent of licensees paying the minimum rental in the Pittwater precincts, whereas all of the licensees in

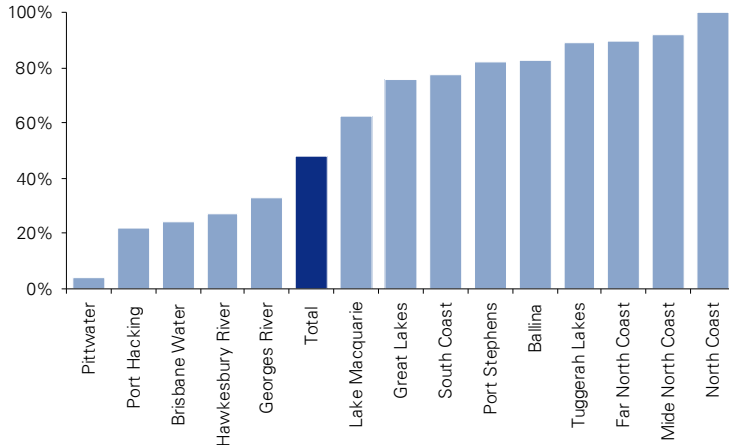
⁷⁸ Rebates and waivers are provided to licensees that have water access only, are pensioners, are located in Crystal Bay or Horseshoe Cove, and for the phase in of rental increases (including from the introduction of the IPART formula in 2004 and changes to the precincts which occurred in 2008). In 2009, rebates and waivers totalled \$506,067, or 7.5 per cent of gross revenue.

⁷⁹ Based on projections of the LPMA's revenue for 2008-09, from LPMA (2009) Annual Report 2007-08: Financial Overview, available from:

http://www.lands.nsw.gov.au/media/lands/pdf/annual_reports/ar_200708/2008_AR_Financial_overview_LowRes.pdf

the macro precincts on the North Coast (including the Bellingen, Clarence and Lower Nambucca precincts) were paying the minimum rental in 2009 (Graph E.2).⁸⁰

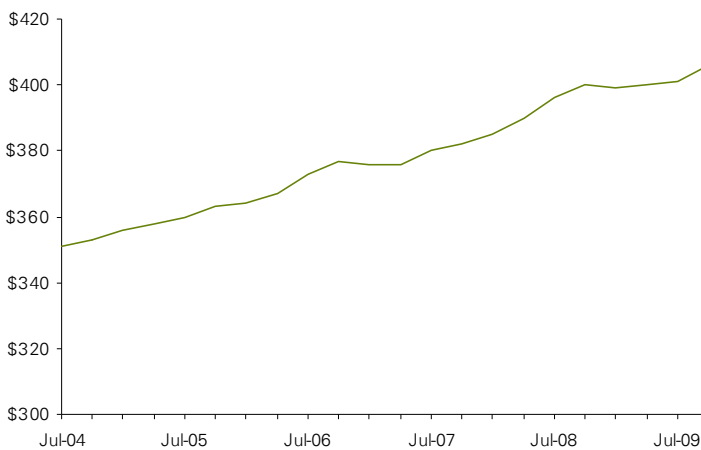
Graph E.2 Share of licensees paying minimum rent in 2009



Source: LPMA

Graph E.3 shows the minimum rent charged for waterfront licences in NSW by the LPMA. The rent charged for water access only licensees is lower, at \$290 a year as at October 2009, compared with \$406 for other licensees. It is important to note that holders of existing waterfront property licences that were paying minimum rent had the increase in rent phased in, paying \$170 in 2004/05, \$270 in 2005/06, and the full minimum rental in 2006/07 (which was equivalent to the initial minimum rent as at 1 July 2004 of \$350 plus the increase due to growth in the Sydney series of the Consumer Price Index).

Graph E.3 Minimum rent charged on waterfront tenancies, July 2004-October 2009



Source: LPMA

For the licensees that pay more than minimum rent, the median rent in 2009 was just over \$800, while the average rent was just over \$1,400 (Table E.1). In some regions, the median rent was much higher, at over \$1,000 a year in the Far North Coast, Pittwater and Port Hacking regions. By contrast, the Hawkesbury region had the lowest median rent for licensees paying above the

⁸⁰ The groupings of precincts in Graph are used throughout this report, and follow geographic lines. The groupings are detailed in Appendix B.

minimum rent, at \$401, which was low given that 68 per cent of properties in the region are water access only, and these licensees pay the higher of the minimum rent, or the rent calculated by the general formula less a rebate, which was \$290 in 2009.

Table E.1 Median rents for licensees paying above the minimum rent

Region	Median rent for licensees paying above minimum rent, 2009	Average annual growth in median rent 2005/06 to 2009/10	Share of licensees with total growth less than Sydney CPI rent series, 2005/06 to 2009/10
Brisbane Water	\$866	4.9%	52%
Georges River	\$890	2.6%	22%
Great Lakes	\$722	6.2%	33%
Hawkesbury River	\$401	10.4%	15%
Lake Macquarie	\$626	2.2%	63%
Mid North Coast	\$503	0.1%	38%
Port Hacking	\$1,092	7.3%	17%
Pittwater	\$1,342	11.5%	17%
South Coast	\$594	2.3%	66%
Total	\$801	4.3%	29%

Notes: Some areas excluded if only a small sample size (less than 10 licensees). The Sydney CPI rent price series increased by 23.1 per cent over the four years to September 2009, which is equivalent to an average annual rate of growth of 5.3 per cent. For the year to September 2009, the Sydney CPI rents series increased by 7.3 per cent. Hawkesbury River median rent was only \$401 in 2009 as there are a large share of water access only properties in this region.

Source: ABS (2009) Consumer Price Index, Australia, Cat. No. 6401.0; LPMA

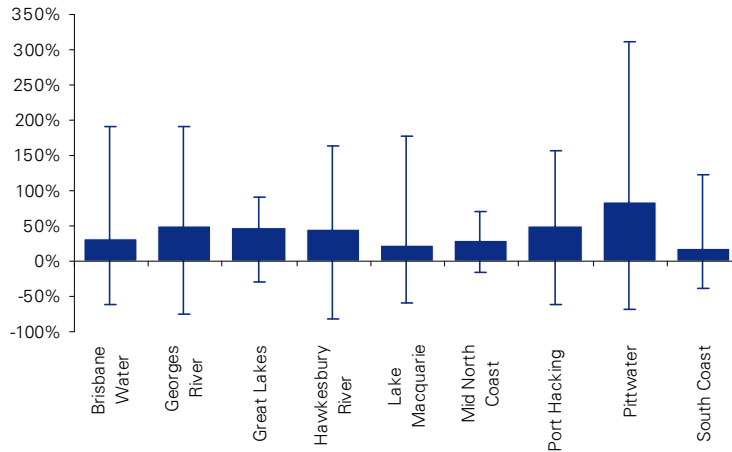
The average annual growth in median rents for licensees paying above minimum rent was 4.3 per cent across all the regions. This was lower than the average annual growth in the Sydney CPI rent price index over the period, which was 5.3 per cent. Some regions saw stronger growth, with median rents in the Pittwater region increasing the most, with average annual growth in the region at 11.5 per cent. By contrast, the median rents in the Mid North Coast remained broadly unchanged over the period.

Overall, nearly a third of all licensees paying more than the minimum rent have seen the total increase in rents over the four years to 2009/10 increase by less than the rate of increase in Sydney CPI rents, which rose by 23 per cent over the period. The share was highest for the South Coast and Lake Macquarie regions, where nearly two thirds of licensees paying more than the minimum rent saw relatively modest increases over the period.

Graph E.4 shows the average growth in rent for licensees paying more than the minimum rent over the period 2005/06 to 2009/10, and the range of rental increases experienced for each region (the maximum and minimum are represented by the error bars). The average rental increase was largest for Pittwater, at 83 per cent, while the average increase in Lake Macquarie was only 22 per cent. Pittwater also had the largest range of rental movements, with some licensees seeing a 67 per cent fall in rents over the four years to 2009/10, while others saw rents increase by over 300 per cent.⁸¹

⁸¹ Note that some licensees have seen rents increased by more than 300 per cent in a given year, however, this is associated with phasing in of rents as well as the switch between micro and macro precincts. It is also important to

Graph E.4 Total growth in rents for licensees paying more than the minimum rent between 2005 and 2009



Source: LPMA

Table E.2 shows the number of licences and revenue earned by the LPMA for both licensees paying minimum rent, and those paying more than minimum rent. It shows that while only half of the licensees pay more than minimum rent, these licensees account for nearly 80 per cent of the revenue earned by the LPMA from this source.

Table E.2 Characteristics of the LPMA's portfolio of waterfront properties

	Paying minimum rent	Paying above minimum rent	Total
Number of licences	3,331	3,457	6,788
Share of total number	49%	51%	
Gross revenue earned	\$1.23m	\$5.57m	\$6.81m
Share of gross revenue	18%	82%	
Net revenue earned*	\$1.33m	\$4.97m	\$6.30m
Share of net revenue	21%	79%	

* Net revenue is less rebates and waivers, which are provided to licensees that have water access only, are pensioners, are located in Crystal Bay or Horseshoe Cove, and for the phase in of rental increases (including from the introduction of the IPART formula in 2004 and changes to the precincts which occurred in 2008). In 2009, rebates and waivers totalled \$506,067, or 7.5 per cent of gross revenue.

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Share of gross revenue	18%	82%	
Net revenue earned*	\$1.33m	\$4.97m	\$6.30m
Share of net revenue	21%	79%	

note that some licensees experienced a fall in rents due to either a decline in PSLVs or with the change to macro precincts.

** Net revenue is less rebates and waivers, which are provided to licensees that have water access only, are pensioners, are located in Crystal Bay or Horseshoe Cove, and for the phase in of rental increases (including from the introduction of the IPART formula in 2004 and changes to the precincts which occurred in 2008). In 2009, rebates and waivers totalled \$506,067, or 7.5 per cent of gross revenue.*

E.2 Key stakeholder concerns

Some stakeholders have commented on the large rental increases since the LMPA introduced the general rental formula recommended by IPART. For example, stakeholders commented that:

“Between 2008 and 2009 the gross rent for my licence increased 23% when the economy and property prices in general were at best stable, and more likely, in decline.”⁸²

“Since 1998 to 2010 licence fee for a jetty has increased by 294.07%, Lake Macquarie City Council rates have increased by 57% and the CPI 39%.”⁸³

“There is clearly something wrong with the system at present when the fee escalates as follows (including GST....which ought not be charged, as with council rates):

2008 fee: \$3296.70

2009 fee: \$4615.60.

2010 fee est: \$6202.53

This represents an increase of some 40 per cent which is totally unjustified in one year and then another 34 per cent increase in the pipeline for next year.....another massive increase which is completely unjustified by movements in property values (which have fallen) or services provided...

The current methods have resulted in my waterfront licence fee increasing from around \$1000 to well over \$4000 in five years: over 400% increase. Such rapid increases in a government tax are simply unfair and have to stop...

The change to the precinct basis for 2009 resulted in an increase in my licence fee from \$3296.70 to \$4615.60, an increase of some 40 per cent from a system which was designed to be fairer, to increase equity. A massive increase in the rent in one year has no equity in it and must be re-examined to isolate the causes of such inequity.”⁸⁴

Many of the stakeholder comments are around the questions of equity of the price increases, volatility, and large increases in the rents. While these concerns are certainly valid, it is important to note the following:

- some of the large increases in rentals were associated with the market rent being phased in over a period of between two and seven years, and as such reflect an upward adjustment of rents after a long period (in some cases 15 years) when rents were not changed for many licence holders; and

⁸² Submission by Simon Flack

⁸³ Submission by James B Whitelaw

⁸⁴ Submission by Davit Nott

- the volatility in rents particularly prior to 2009 is likely to be partly due to the relatively small number of properties included in the individual micro precincts.

F Detailed analysis

This appendix presents our detailed analysis for selected sections of the report.

F.1 Data sources

This section provides our detailed analysis on the data sources that could be used to estimate the ROR. The two sets of data analysed in this section and the body of the report are:

- data sourced from Residex, a property data company which collects information from Government Departments and Real Estate Agencies and publishes these data in reports that can be purchased; and
- data from Housing NSW, which publishes quarterly rent and sales reports based on rental data derived from information provided on rental bond lodgement forms, and sales data from information provided on the 'Notice of Sale or Transfer of Land' form that is lodged with the Land and Property Information NSW at the Department of Lands.⁸⁵

To look at the quality of the Residex and Housing NSW data sources, we looked at the median rental price and rental return data for houses in the Sydney region. It is important to note that the two data sources define the geographical region of Sydney differently. Specifically, Housing NSW uses the Sydney SD as defined in the ABS *Australian Standard of Geographical Classification*.⁸⁶ By contrast, Residex defines the Sydney region by postcode, and does not include a number of postal areas that are included in the Sydney SD. Specifically the postcodes in the following regions are not included in the Residex definition:

- Gosford and Wyong region (2250-2263 postcodes);
- Bargo and Mowbray Park region (2571-2574 postcodes); and
- Blue Mountains region (2773-2787 postcodes).

Graph F.1 shows the median rental price series from both sources. It is important to note that the Housing NSW data available online is only available disaggregated into size of the property, as measured by the number bedrooms within a dwelling. Specifically, data is published on the median rent for all new dwellings for one, two, three and four or more bedroom dwellings; for one and two bedroom apartments and units; and for two and three bedroom houses. The Residex data used by IPART was the median rent for houses, and all sizes. The Housing NSW data used in this graph, which reflects rents on houses in the Sydney SD, was purchased for a small charge.

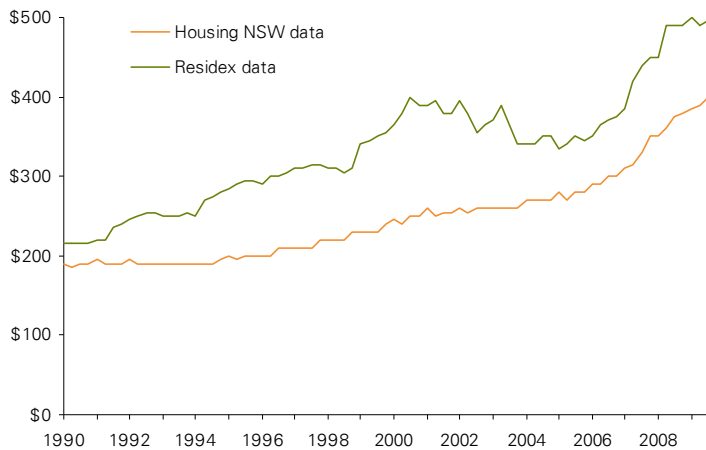
⁸⁵ See for example Housing New South Wales (2009) Rent and Sales Report No. 88. Available from:

<http://www.housing.nsw.gov.au/NR/rdonlyres/76053533-0992-4487-837B-3FFA2BDB2BFA/0/RSReport88.pdf>

⁸⁶ See ABS (2009) Australian Standard of Geographical Classification, July 2009: New South Wales Maps, Cat. No. 1216.0, available from:

[http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/E7BA98B98DF78561CA2576320019F3B4/\\$File/12160_ju19%202009_nsw%20maps.pdf](http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/E7BA98B98DF78561CA2576320019F3B4/$File/12160_ju19%202009_nsw%20maps.pdf)

Graph F.1 Housing NSW and Residex rental data, quarterly, Sydney SD



Source: Housing NSW; Residex

Graph F.1 shows somewhat different trends between Residex and Housing NSW data. While the two series are broadly consistent in 1990, with Residex data 13 per cent higher than Housing NSW data in March 1990, the differential between the data widens through the beginning of this decade and is at its largest in the September quarter 2000 when the median Sydney house rent price published by Residex was 60 per cent higher than that published by Housing NSW.

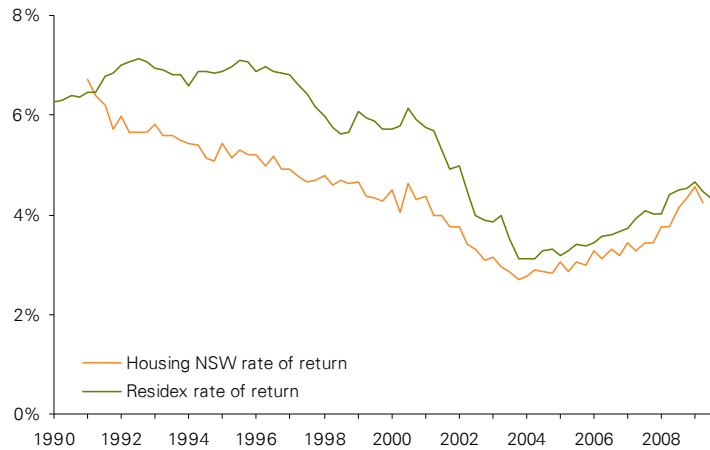
For the first three quarters of 2009, Residex has published Sydney rent data that was on average 26 per cent, or around \$100 a week higher than the data published by Housing NSW. This difference is likely due to the fact that Residex data is based on published rents (from advertisements) rather than the actual rent paid as is the case with Housing NSW data (which is based on information derived from rental bond forms lodged with the Rental Bond Board). As such the data from Housing NSW is more accurate, as it reflects the actual rents paid by tenants, rather than the asking rents.

Residex data is also more volatile, which can be seen in the relatively large movements of the series. The range of the quarterly growth in the series is much narrower for Housing NSW, with the movements between -3.8 per cent and 6.1 per cent, compared with a range for Residex data of -6.8 per cent and 9.7 per cent.

Graph F.2 shows the quarterly rental ROR based on Residex and Housing NSW data for houses in the Sydney SD. The two series clearly follow the same broad trends, though the ROR for the Residex data is the more volatile. Indeed the coefficient of variation, a measure of volatility and the rate of change for a time series, is also lower for the Housing NSW data, at 0.24, while the Residex data shows a coefficient of variation at 0.26.⁸⁷

⁸⁷ The coefficient of variation is given by the standard deviation of a series divided by its mean. It is a useful measure because, unlike the standard deviation, it can be used to compare data sets when the means differ substantially.

Graph F.2 Rental rate of return on houses in the Sydney SD



Source: Housing NSW; Residex

This analysis shows that Housing NSW data is more accurate, given it is based on actual rents paid (based on Rental Bond Board lodgement forms) and is for the entire Sydney SD, and it produces a less volatile ROR series than the series based on Residex data. Moreover, Housing NSW data is preferable as it can potentially be made more readily available (although at present comparable data needs to be purchased from Housing NSW for a small fee, and is not published online). However, given that the data currently published online by Housing NSW does not line up exactly with the data published on house sales, the LPMA and Housing NSW might work together to make publicly available data that would allow individuals to replicate LPMA's calculations of rents on domestic waterfront tenancies (and in doing so ensure that rent is set transparently). Given this proviso, KPMG considers recommends that the LPMA move to using Housing NSW data in calculating the ROR.

F.2 Time horizon for calculating the rate of return

This section provides our analysis on the time horizon for calculating the ROR. We consider three options for calculating this time horizon, these being:

- a single year average;
- a three-average, consistent with the current averaging period for PSLVs; and
- a 10 year average, consistent with the current approach.

Table F.1 shows the rolling average rates of return on Sydney rental properties, using a single year, three-year, and 10-year time horizon. It indicates that the time horizon does have an impact on the ROR. This occurs on two fronts.

- The difference between the level of returns under each approach can be quite large. For example, the return in 2009 varied by 0.39 percentage points, and in 2008 the variation was 0.79 percentage points, with an average of 0.68 percentage points over the period.

- The volatility of the returns is also different over time. The coefficient of variation, which is the most accurate comparison measure of volatility of different data series, shows that the volatility appears to be the lowest for the 10-year average, followed by the three and single year averages respectively. That said, given that the data used to calculate each series is based on a different time period, the general trend of each individual time series can impact on the estimated coefficient of variation, hence it should be treated with caution.⁸⁸

Table F.1 Rolling average gross rates of return, Sydney SD rents, Housing NSW data

Date*	One-year rolling average	Three-year rolling average	10-year rolling average
2001	4.32%	4.39%	5.02%
2002	3.73%	4.11%	4.81%
2003	3.13%	3.73%	4.55%
2004	2.80%	3.22%	4.28%
2005	2.90%	2.94%	4.05%
2006	3.11%	2.94%	3.85%
2007	3.30%	3.10%	3.68%
2008	3.60%	3.34%	3.58%
2009	4.32%	3.74%	3.55%
Average	3.47%	3.50%	4.15%
Coefficient of Variation	0.16	0.15	0.13

** June year-end*

Source: Housing NSW; KPMG calculations

Nonetheless, the analysis does demonstrate some of the volatility differences between the different data series. Intuitively the results make sense. One would expect the 10 rolling average to be less volatile than the 3 year, followed by the 1 year because of the longer term averaging effect of the long periods. This is the outcome illustrated by the Coefficient of Variation.

In any case, whilst the above analysis provides some information for considering the ROR, what really matters is how the ROR combines with PSLVs to determine rent. It is the volatility in rents which is what really matters. To illustrate the impact of using a different ROR on the rent charged to a waterfront licensee, we have used the single year, three-year and 10-year rolling average RORs for 2008 and 2009, and assumed that the:

- waterfront licence is for a land area of 100 square metres (the average in 2009 was 111 square metres);
- precinct statutory land value (PSLV) was set at the average for 2008, at \$1,000 and then the PSLV grown by the growth in the three year average house prices for the Sydney SD in 2009, to \$989;
- discount factor was 50 per cent (as in the IPART formula); and

⁸⁸ The coefficient of variation represents the ratio of the standard deviation to the mean, and it is a useful statistic for comparing the degree of variation from one data series to another, even if the means are drastically different from each other.

- outgoings equivalent to 2.5 per cent was subtracted from the gross ROR to obtain the net return.

Table F.2 below sets out the resulting net ROR based on the above assumptions and the resulting PSLVs derived from using the above inputs in the rental formula. Results are shown for five macro precincts.

Table F.2 Rates of return for the Sydney SD based on different averaging periods, and three-year rolling average PSLVs for selected regions

	2007	2008	2009
Net rate of return, based on Sydney SD*			
One-year rolling average	0.80%	1.10%	1.82%
Three-year rolling average	0.60%	0.84%	1.24%
10-year rolling average	1.18%	1.08%	1.05%
Current rate	3.05%	3.05%	3.05%
Three-year rolling average PSLVs			
Brisbane Water West	\$849	\$855	\$908
Georges River	\$1,004	\$996	\$965
Lake Macquarie	\$452	\$442	\$573
Pittwater	\$1,547	\$1,562	\$1,486
Port Hacking	\$1,449	\$1,542	\$1,264

* June year end, assuming outgoings of 2.5 per cent.

Source: Housing NSW; LPMA

Table F.3 show the impact of changing the ROR used on the estimated rent for the five selected macro precincts.⁸⁹ Sufficient data to undertake this exercise by macro precinct was only available for between 2007 and 2009. Table F.3 shows the following:

- the calculated rent is substantially lower than the previous calculated rent for the period when the ROR is updated using any of the different averaging methods. For example, Table F.3 shows that for Brisbane Water, the current method of calculating rent yielded a result of between \$2,589 to \$2,770 (for a property that is 200 square metres) whilst the ranges for the one, three and updated 10-year averages range from \$513 (three-year 2007) to \$1,654 (single year 2009);
- each averaging method provides a different 'highest rent calculation' for each of the three years shown;
- the volatility of the rent calculation is lowest when the 10-year average is applied, and updated annually; and

⁸⁹ The precincts were chosen to ensure that a range of geographic areas were covered (in particular ensuring that the areas in which the largest share of licensees are located were covered), and within each of the geographic areas, the macro precincts were chosen on the basis that they included the largest share of licensees. Specifically, the following precincts were chosen: Brisbane Water West, which has 456 licensees, equivalent to 6.7 per cent of the total number of licences outstanding in 2009; Georges River 2 with 382 licensees, or 5.6 per cent; Lake Macquarie 1 with 703 licensees, or 10.4 per cent; Pittwater 2 with 333 licensees or 4.9 per cent; and Port Hacking 1, with 418 licensees or 6.2 per cent.

- applying the current ROR of 3.05 per cent each year appears to produce rents with the lowest year-to-year fluctuations based on the specific assumptions we have applied.

This would suggest that the 10-year ROR, updated annually, would have possibly provide the most reasonable result in the sense that the resulting rents exhibit lower levels of volatility when compared to the other approaches, and the level of rent is within the range of the other two methods. This is despite the fact that it takes into account information that is least current and theoretically may be perceived to be the least representative of the current market ROR.

However, these results do not provide sufficient evidence to rule out any option at this stage of the analysis as the results shown in Table F.3 are very much based on the specific inputs applied and these inputs do vary from year to year. For example, whilst the 10-year average produces a rent that is in between the three and single year average, in 2004 at the time of the IPART decision, the 10-year average was substantially higher. This level difference may suggest that the 10-year average can lead to unrealistic outcomes. This is illustrated in Graph F.3 below, where the rent calculated using the 10-year average was significantly higher than the three-average in 2004. However, the rents converge by the end of 2009, in line with the fall in the 10-year ROR over the period. Hence there would appear to be a trade-off between the volatility of rents, and the most appropriate level of market rent. Given this, neither option can be ruled out at this stage.

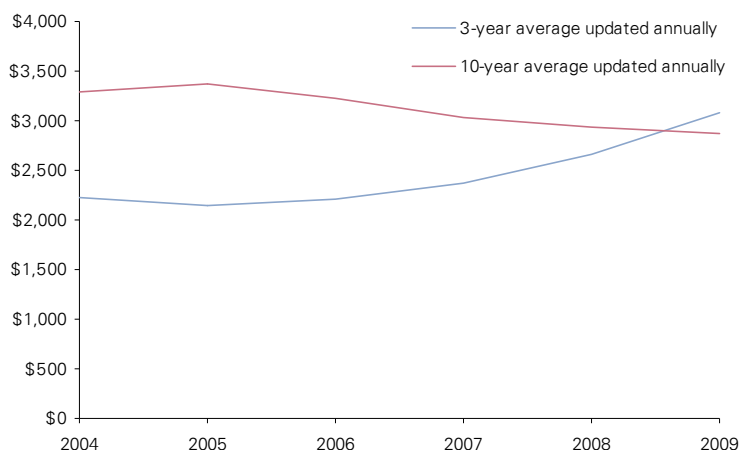
*Table F.3 Impact of changing the rate of return on rents**

Net rate of return measure	Estimated rent			Difference relative to current			Growth in rent	
	2007	2008	2009	2007	2008	2009	2008	2009
Brisbane Water West								
One-year average	\$678	\$942	\$1,654	-74.0%	-63.9%	-40.3%	38.9%	75.5%
Three-year average	\$513	\$717	\$1,127	-80.2%	-72.5%	-59.3%	39.9%	57.1%
10-year average	\$1,004	\$920	\$953	-61.2%	-64.7%	-65.6%	-8.4%	3.7%
Current rate	\$2,589	\$2,609	\$2,770				0.8%	6.2%
Georges River 2								
One-year average	\$802	\$1,097	\$1,758	-73.8%	-63.9%	-40.3%	36.7%	60.2%
Three-year average	\$607	\$835	\$1,198	-80.2%	-72.5%	-59.3%	37.7%	43.4%
10-year average	\$1,188	\$1,071	\$1,013	-61.2%	-64.7%	-65.6%	-9.8%	-5.4%
Current rate	\$3,062	\$3,038	\$2,945				-0.8%	-3.1%
Lake Macquarie 1								
One-year average	\$361	\$486	\$1,043	-73.8%	-63.9%	-40.3%	34.7%	114.4%
Three-year average	\$273	\$370	\$711	-80.2%	-72.5%	-59.3%	35.6%	91.9%
10-year average	\$535	\$475	\$601	-61.2%	-64.7%	-65.6%	-11.2%	26.6%
Current rate	\$1,379	\$1,347	\$1,747				-2.3%	29.7%

Net rate of return measure	Estimated rent			Difference relative to current			Growth in rent	
	2007	2008	2009	2007	2008	2009	2008	2009
Pittwater 2								
One-year average	\$1,236	\$1,720	\$2,706	-73.8%	-63.9%	-40.3%	39.2%	57.3%
Three-year average	\$934	\$1,309	\$1,844	-80.2%	-72.5%	-59.3%	40.1%	40.8%
10-year average	\$1,830	\$1,679	\$1,560	-61.2%	-64.7%	-65.6%	-8.2%	-7.1%
Current rate	\$4,717	\$4,763	\$4,534				1.0%	-4.8%
Port Hacking 1								
One-year average	\$1,158	\$1,699	\$2,301	-73.8%	-63.9%	-40.3%	46.7%	35.5%
Three-year average	\$875	\$1,293	\$1,568	-80.2%	-72.5%	-59.3%	47.7%	21.3%
10-year average	\$1,714	\$1,658	\$1,327	-61.2%	-64.7%	-65.6%	-3.3%	-20.0%
Current rate	\$4,421	\$4,704	\$3,855				6.4%	-18.0%

** June year-end, based on Sydney SD data for the ROR, using the assumption that outgoings are equivalent to 2.5 per cent. Also based on PSLVs for the regions, and assumes that the occupancy area is 200 square metres
 Source: Housing NSW; LPMA; KPMG calculations*

Graph F.3 10-year versus three-year average ROR impact on rents



*Notes: Based on June year-end RORs, and assumes that the occupancy area is 100 square metres, outgoings are equivalent to 1.0 per cent, the SLV is equal to \$1,000 in 2004, and the SLV increases in line with the annual growth in three-year average of the Sydney SD median house prices.
 Source: Housing NSW; LPMA; KPMG calculations*

F.3 Geographical area over which the rate of return is updated

In order to test whether there is a case to moving to using geographical RORs to calculate rents on waterfront tenancies, KPMG obtained data on the median rent paid and the median sales price on all dwellings in the macro precincts. The rent data was obtained from Housing NSW, while sales data was obtained from the LPMA.

It is important to note at the outset that there are a number of data constraints which suggest that it would not be appropriate to move to using geographical RORs at this stage. Specifically, the data constraints relate to:

- availability of rental data for each of the macro-precinct regions, with some of the smaller regions outside of Sydney having either patch or no rental data;
- systems within the LPMA that make it difficult to easily obtain historic PSLV data, hence making it difficult to look at the longer term impact of moving to geographic averages on rents; and
- systems within both the LPMA and NSW Housing that are not established to easily obtain data on rents and sales prices at the macro precinct level, which means that there would be little transparency or simplicity around updating the rental formula.

Given the current data constraints, and the lack of consistent and sufficiently long time series over which to undertake an analysis, we recommend in the report that the Sydney SD should remain as the geographical area for averaging, despite the other concerns regarding using this area. This is based on two main factors. Firstly, the quality of the data to determine macro precinct based rates of return is insufficient for use at this time.

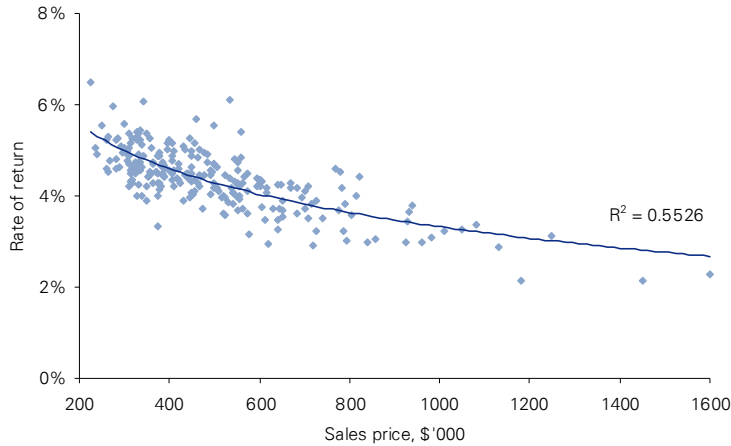
Secondly, maintaining a single ROR for the general formula is better able to achieve the aims of simplicity and transparency. However, over the next few years, the LPMA could work with Housing NSW to set up a database and collect sufficient data based on macro precincts for consideration at its next review. Moreover, if the decision is made at the next review to shift to RORs on a macro precinct, or even a whole of waterway or region basis, then the transparency of the rental charges could be improved if the LPMA and Housing NSW were to work together to ensure that data on rents and sales prices for these regions are made publicly available on the Housing NSW or LPMA websites.

That said, we provide below a brief analysis on the data that is available at present to consider the theoretical principles of moving to geographically based RORs. It is our intention that this analysis may assist others in a future review, once sufficient data is available.

Based on the data available we have calculated the rental ROR in the June quarter 2009 for each of the postcodes for which data are available. Graph F.4 shows the ROR against the sales price for each of the postcodes and the statistic trend line that best fits the relationship between ROR and sales price for all postcodes.⁹⁰ What is clear is that there is an inverse relationship between the ROR and sales price, indicating that the ROR and SLV are generally inversely related, although that relationship can vary by geographic area.

⁹⁰ The R² statistic Statistical measure of how well a regression line approximates real data points; an R² of 1.0 (100 per cent) indicates a perfect fit.

Graph F.4 Rate of return versus sales price, by postcode, June 2009



Source: Housing NSW

This can be seen in Table F.4 which includes the median rent, median sales price, PSLVs and three-year average ROR for each of the macro precincts based on data from Housing NSW and the LPMA (presented in increasing order of ROR). What is clear is that for the areas with a higher median sales price, such as Pittwater 1, Georges River 1 and Kingscliff, the ROR is lower, with the RORs for these regions 3.21 per cent, 2.38 per cent and 2.80 per cent respectively compared with 3.74 per cent for the Sydney SD. By contrast those areas with relatively low median sales prices, such as Lower Nambucca, Greater Taree, and Clarence, the ROR is relatively high, at 4.05 per cent, 4.23 per cent and 4.46 per cent.

Table F.4 Median rent and sales price, three year average RORs and PSLVs for macro precincts

Macro precinct	Median rent per week, all dwellings, 2008	Median sales price, all dwellings, 2008	PSLVs, 2009, per square metre*	Three-year average rate of return, 2008
Port Hacking 1	\$340	\$820,000	\$1,264	1.95%
Pittwater WAO	\$450	\$1,050,000	\$566	2.16%
Georges River 1	\$370	\$750,000	\$1,317	2.38%
Pittwater 2	\$495	\$968,500	\$1,486	2.45%
Port Hacking 2	\$370	\$721,000	\$977	2.51%
Narrabeen Lagoon	\$450	\$820,000	\$1,457	2.66%
Georges River 2	\$360	\$610,500	\$965	2.78%
Kingscliff	\$330	\$692,000	\$1,920	2.80%
Port Hacking 3	\$400	\$630,000	\$652	2.90%
Hawkesbury River WAO 4	\$300	\$517,500	\$416	2.91%
Ballina West	\$280	\$500,000	\$746	2.98%
Tabourie Creek	\$205	\$327,600	\$513	3.01%
Pittwater 4	\$625	\$1,050,000	\$1,222	3.05%
Conjola Lake	\$220	\$327,600	\$140	3.09%
Georges River 3	\$360	\$529,000	\$584	3.17%
Wallamba Cove	\$210	\$310,000	\$637	3.19%
Pittwater 1	\$700	\$1,050,000	\$2,271	3.21%
Pambula - Merimbula	\$220	\$350,000	\$651	3.21%
Burrill Lakes	\$225	\$317,000	\$692	3.34%
Pittwater 3	\$800	\$1,200,000	\$2,547	3.35%
Tweed	\$320	\$465,000	\$480	3.50%
Tomaga - Moruya - Tuross	\$220	\$305,000	\$364	3.52%
Georges River 5	\$300	\$380,000	\$415	3.59%
Hawkesbury River WAO 1	\$420	\$500,000	\$98	3.62%
St George Basin - Sussex Inlet	\$200	\$270,000	\$304	3.63%
Hastings	\$250	\$337,500	\$194	3.68%
Clyde River	\$235	\$315,000	\$287	3.71%
Brisbane Water West	\$260	\$340,000	\$908	3.72%
Sydney SD	\$380	\$480,000	-	3.74%
The Anchorage	\$265	\$349,000	\$686	3.75%
Ballina East	\$360	\$500,000	\$61	3.83%
Georges River 4 WAO	\$490	\$572,500	\$391	3.84%
Brisbane Water East	\$300	\$375,000	\$748	3.84%
Hawkesbury River 5	\$295	\$355,000	\$97	3.85%

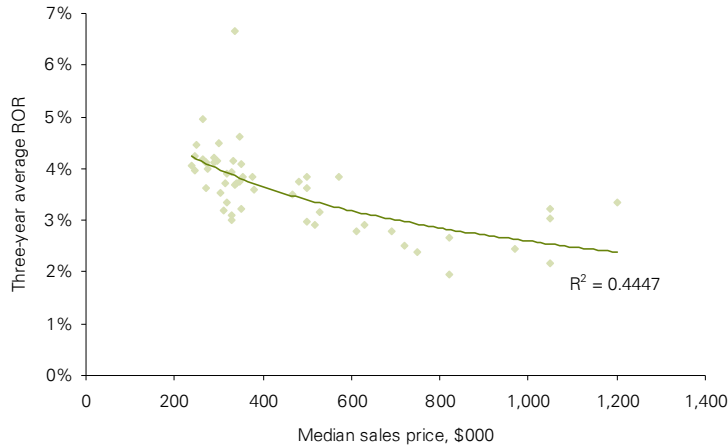
Macro precinct	Median rent per week, all dwellings, 2008	Median sales price, all dwellings, 2008	PSLVs, 2009, per square metre*	Three-year average rate of return, 2008
Port Stephens	\$260	\$320,000	\$212	3.89%
Richmond	\$250	\$330,000	\$121	3.93%
Wagona - Wallaga	\$200	\$245,000	\$83	3.97%
Great Lakes	\$220	\$275,000	\$95	4.00%
Lower Nambucca	\$190	\$239,000	\$90	4.05%
Murwillumbah	\$285	\$350,000	\$244	4.08%
Currambene Creek	\$240	\$270,000	\$682	4.11%
Crookhaven - Shoalhaven	\$230	\$270,000	\$537	4.13%
Tuggerah Lakes	\$250	\$290,000	\$360	4.13%
Lake Macquarie 1	\$255	\$295,000	\$573	4.14%
Lake Macquarie 2	\$285	\$332,500	\$1,102	4.14%
North Arm Cove	\$225	\$265,000	\$348	4.17%
Bellingen	\$250	\$289,000	\$88	4.22%
Greater Taree	\$220	\$245,000	\$164	4.23%
Clarence	\$230	\$250,000	\$60	4.46%
Lake Macquarie 3	\$280	\$300,000	\$499	4.50%
Hawkesbury River 3	\$340	\$346,000	\$550	4.62%
Tea Gardens	\$260	\$265,000	\$1,061	4.96%
Hawkesbury River WAO 2	\$440	\$335,000	\$203	6.67%
Currarong Creek**	-	\$270,000	\$954	-
Womboyn River**	-	\$290,000	\$28	-

* Data for 2009 PSLVs included as the 2008 data is not as accurate; however, for all other series in the table, 2008 data is used as the sales value data are only to 2008

** Insufficient data to calculate a three-year rolling average rate of return, due to lack of rental data

Graph F.5 shows the three-year average RORs for the macro precincts against the median sales price in 2008. As with the case of the postcode data for the Sydney region, we find there is an inverse relationship between returns and prices. This indicates that RORs are likely to differ by location, though in itself, it does not prove this.

Graph F.5 Three year average rates of return against median sales prices, macro precincts



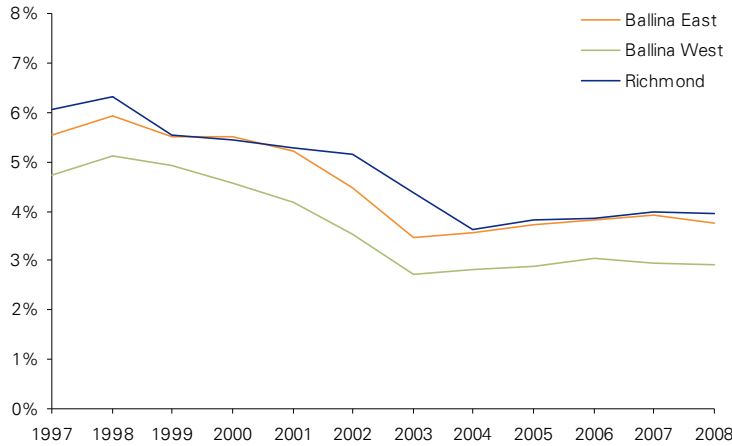
Source: Department of Housing; LPMA

Graph F.6 to Graph F.19 show the gross rental rates of return for the macro precincts, grouped according to geographical areas, for the period 1997 to 2008. The data are annual, and have some missing values due to small sample sizes. This is particularly the case for rents. Indeed, some macro precincts have no rental data due to small sample sizes for most of the periods. The macro precincts with the most significant data gaps are:

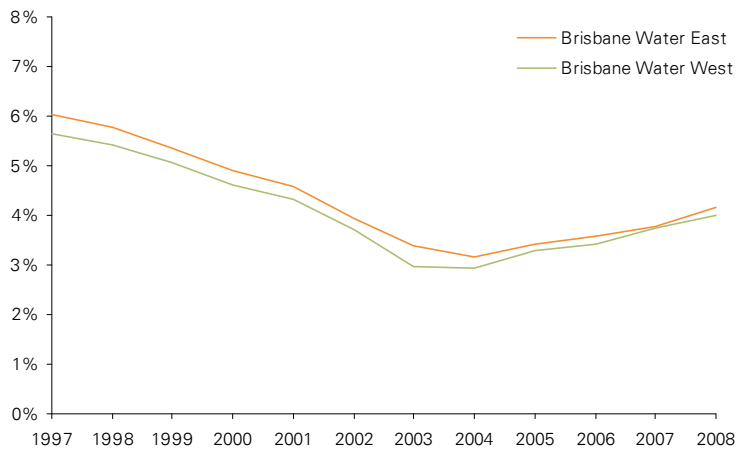
- Curragong Creek;
- Hawkesbury River WAO 2;
- North Arm Cove;
- Tabourie Creek; and
- Womboyn River (for which there is no rental data available over the entire period from 1990 to 2008).

This series of graphs indicates that the RORs do appear to be location specific, with the returns varying somewhat between different geographical regions, as well as over time.

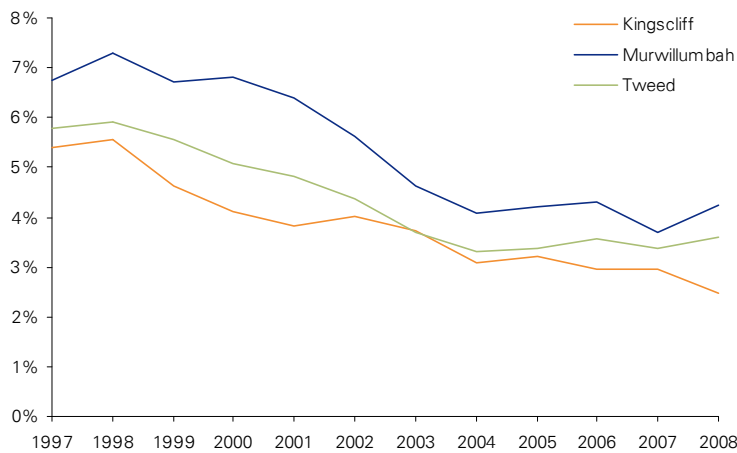
Graph F.6 Rental rates of return for macro precincts in the Ballina region



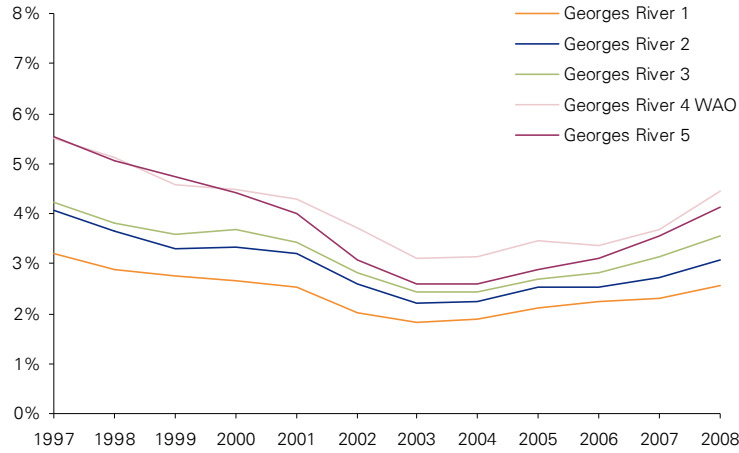
Graph F.7 Rental rates of return for macro precincts in the Brisbane Water region



Graph F.8 Rental rates of return for macro precincts in the Far North Coast region



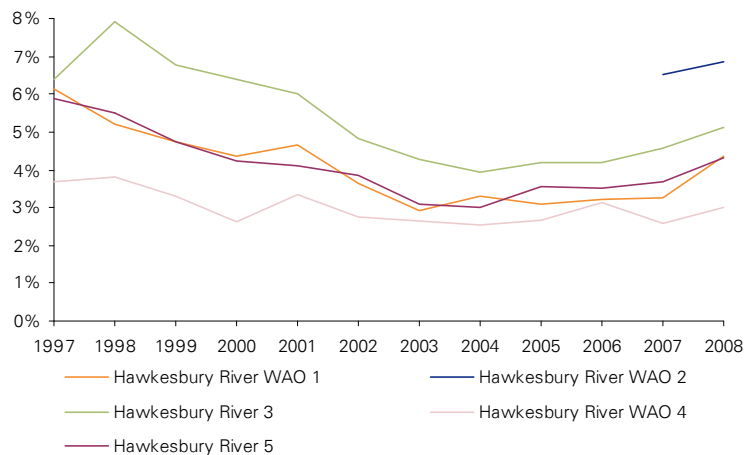
Graph F.9 Rental rates of return for macro precincts in the Georges River region



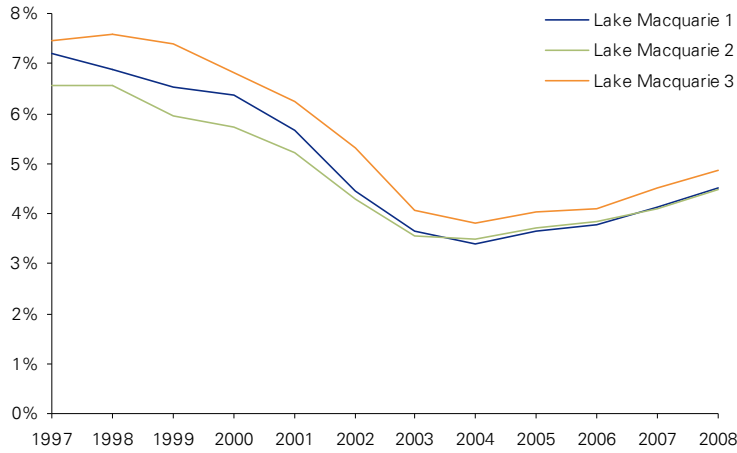
Graph F.10 Rental rates of return for macro precincts in the Great Lakes Upper Hunter region



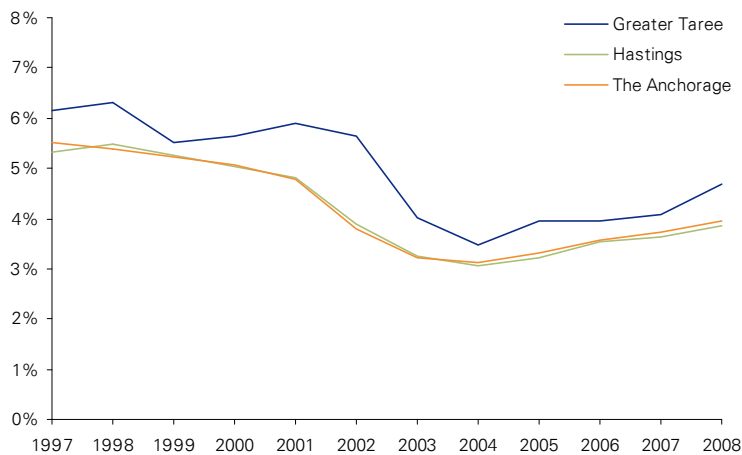
Graph F.11 Rental rates of return for macro precincts in the Hawkesbury River region



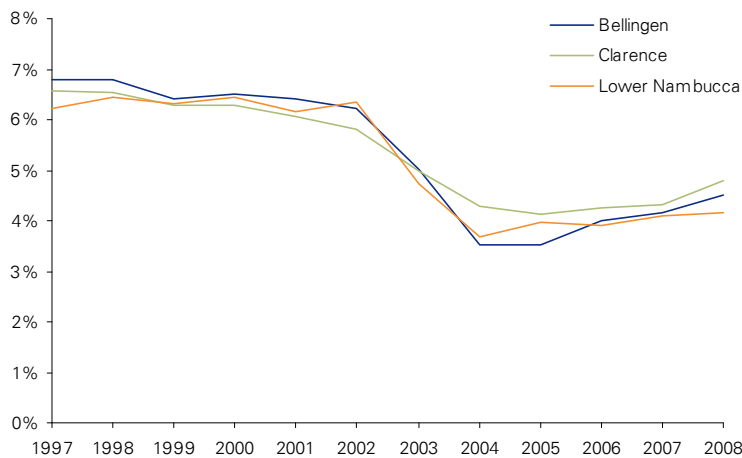
Graph F.12 Rental rates of return for macro precincts in the Lake Macquarie region



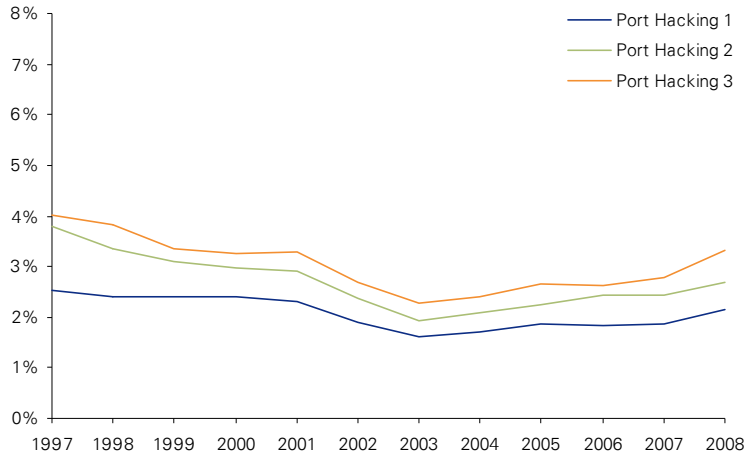
Graph F.13 Rental rates of return for macro precincts in the Mid North Coast region



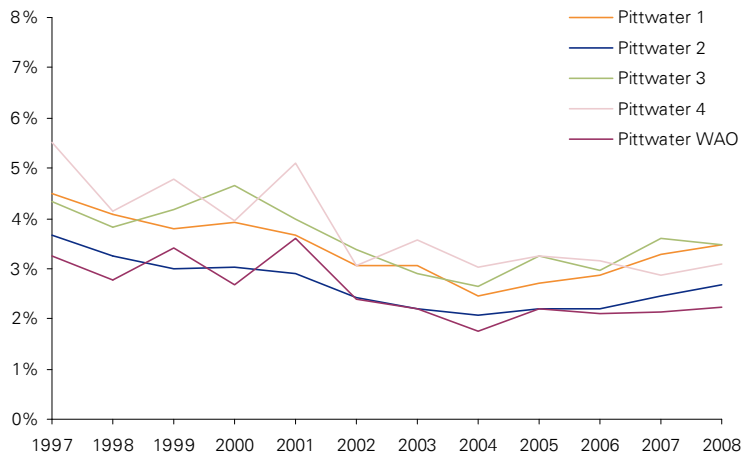
Graph F.14 Rental rates of return for macro precincts in the North Coast region



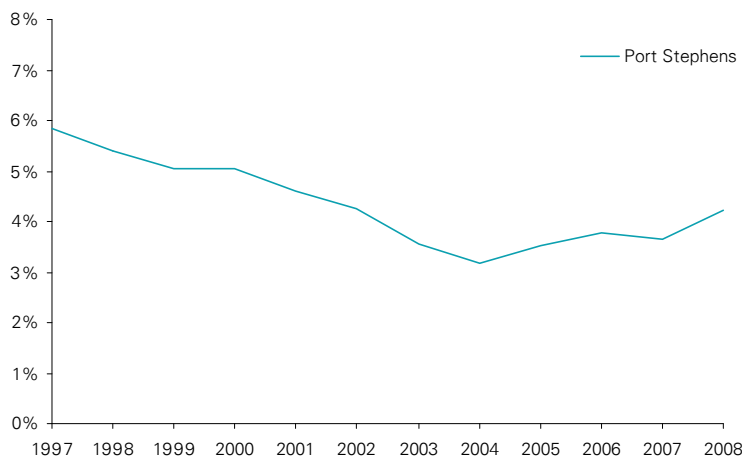
Graph F.15 Rental rates of return for macro precincts in the Port Hacking region



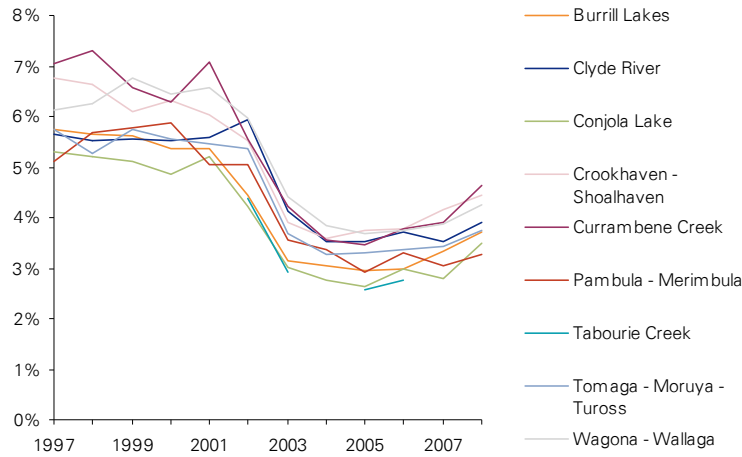
Graph F.16 Rental rates of return for macro precincts in the Pittwater region



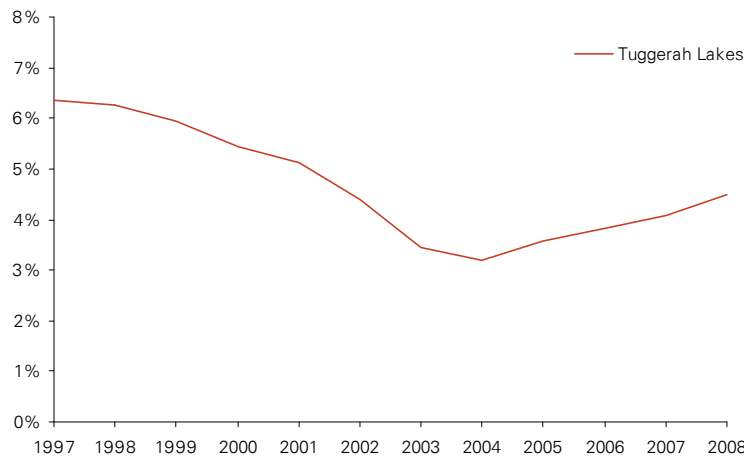
Graph F.17 Rental rates of return for macro precincts in the Port Stephens region



Graph F.18 Rental rates of return for macro precincts in the South Coast region



Graph F.19 Rental rates of return for macro precincts in the Tuggerah Lakes region



Putting aside from data problems in the first instance, we look at the impact of switching to using geographic RORs by examining three precincts within which a large share of the licensees are situated. These are Brisbane Water West, Hawkesbury River 4 WAO and Lake Macquarie 1, which accounted for 6.7 per cent, 2.5 per cent and 10.4 per cent of licences in 2009, respectively. For this analysis we assume:

- an occupancy area of 200 square metres;
- the PSLVs are an average of the micro precinct PSLVs within a macro precinct region;
- three-year average rates of return are used; and
- outgoings are assumed to be equivalent to one percentage point.

Table F.5 Estimated rents based on geographical average RORs

Year	Three-year average PSLV	Three-year average net rate of return	Rent		Difference to Three-year Sydney ROR	Growth in rent	
			Three-year Sydney ROR	Geographic ROR		Three-year Sydney ROR	Geographic ROR
Brisbane Water West							
2006	\$832	2.21%	\$1,614	\$1,842	14.2%	-	-
2007	\$849	2.49%	\$1,786	\$2,109	18.1%	10.7%	14.5%
2008	\$855	2.72%	\$2,000	\$2,328	16.4%	12.0%	10.4%
Hawkesbury River 4 WAO							
2006	\$547	1.77%	\$213	\$195	-8.5%	-	-
2007	\$472	1.79%	\$147	\$126	-14.7%	-30.7%	-35.4%
2008	\$453	1.91%	\$167	\$136	-18.1%	13.0%	8.6%
Lake Macquarie 1							
2006	\$493	2.61%	\$955	\$1,284	34.4%	-	-
2007	\$452	2.86%	\$951	\$1,291	35.8%	-0.4%	0.6%
2008	\$442	3.14%	\$1,033	\$1,387	34.3%	8.6%	7.4%

Note: Three-year Sydney rolling average net ROR was 0.44 per cent in 2006; 0.60 per cent in 2007; and 0.84 per cent in 2008 when outgoings are assumed to be 2.5 per cent of the value. Geographic RORs are calculated using annual data, while the Sydney ROR is calculated using quarterly data with a June year-end.

Source: Housing NSW; LPMA; KPMG calculations

Table F.5 shows the estimated rents from 2006 to 2008 for these regions. What is clear is that for both the Brisbane Water West and Lake Macquarie 1 regions, rents based on three-year rolling averages ROR would be higher than the rents calculated using data on the Sydney SD ROR (but lower than the current ROR of 3.05 per cent), but the rents would be lower when the Sydney SD ROR is used for the Hawkesbury River 4 WAO region.

This would suggest that moving to geographically based averaging may provide RORs that are both above and below the Sydney SD ROR for the different macro precinct. However, as indicated at the start of this section, the data is insufficient to draw any strong conclusions at present, let alone for use in estimating RORs. A similar analysis would be useful the next time the ROR is reviewed, once sufficient data is available. However, any switch to geographical averaging of ROR would need to be based on a reasonable check of the impacts on rents, and a consideration of the balance between the policy objectives of simplicity and equity.

F.4 Frequency of updates to the rate of return

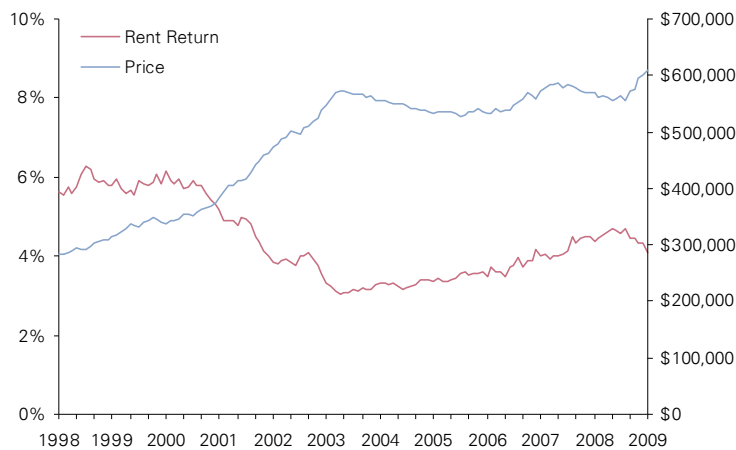
This section provides our detail analysis on how often the ROR should be updated. Section F.4.1 analyses the interaction between the components of the rental formula, Section F.4.2 provides IPART's point of view and Section F.4.3 provides KPMG's independent analysis.

F.4.1 Interaction between components of the rental formula

To test the claim that there is an inverse relationship between the ROR and median house price, data from Residex for the Sydney SD from 1998 (Graph F.20) is used. This shows that:

- in the period to mid 2006, there was a strong inverse relationship between returns and house prices, with the correlation coefficient at -0.98 for the period September 1998 to June 2006;
- between mid 2006 and the end of 2007, there is a positive relationship between rental returns and house prices, with a correlation coefficient of 0.81 between July 2006 and December 2007; and
- in 2008 and beyond, the relationship returned to one which is inverse for 2008 and 2009, with the correlation between prices and rental returns being -0.75 for the period January 2008 to September 2009.

Graph F.20 Rental return and median house prices, Sydney SD

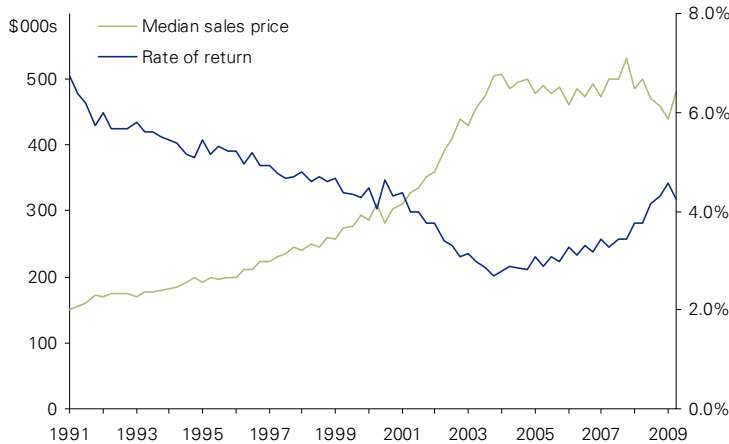


Source: Residex; KPMG calculations

A similar story is depicted in Graph F.21 which shows comparable ROR and price data for the Sydney SD for the March 1991 to June 2009 using data sourced from the Department of Housing (median rental prices) and Department of Lands (median sales prices).⁹¹ In particular, prior to 2003, a stronger inverse relationship between house prices and rates of returns is apparent. While the strength of the inverse relationship is however weaker over the most recent seven years, there is still a correlation coefficient of -0.92 for the entire period.

⁹¹ This is estimated as the median rental price for a two-bedroom house (multiplied by seven, divided by 365) over the median sales price, by region.

Graph F.21 Rental return and median house prices, Sydney SD



Source: Housing NSW; KPMG calculations

This brief analysis, and Section F.3, both show that relationship between the ROR and land values would appear to have been largely inverse over the last 10 to 20 years. That said, there were periods over the last ten years where this relationship was weak and even positive for some years. By definition, the ROR is a function of both rents and statutory land values. Therefore, the size of the ROR and whether there is positive or inverse relationship between RORs and property prices is dependent upon the relative size and direction of the movement in rents versus SLVs from year to year. The size and direction of movements in rents and SLVs, in turn, will be influenced by demand and supply conditions in the rental property market and the market for properties for sale. In a situation where there is demand for rental properties exceeds supply, it is likely that rentals will rise. If this rise exceeds the rise in land values, the ROR will rise. For example, one consultancy firm is predicting Sydney rents to climb more than 21 per cent over the next three years.⁹²

F.4.2 IPART’s view

In its 2004 report IPART did not explicitly indicate how often the ROR should be reviewed. Rather it indicated that “this ROR will need to be reviewed regularly.”⁹³ In response to comments by some stakeholders, and a recent Local Land Board decision, IPART provided an update to clarify its views. IPART has since indicated that once every three years would be appropriate.⁹⁴

In addition, IPART has clarified its views on why it suggests that SLVs should be updated each year, whilst the ROR only needs to be updated every three years.

“IPART recommended that the current SLV of the adjoining freehold land should be used and based the calculation in its report on the current SLV. This is because we were required by the terms of reference for the 2004 review to set rents “to reflect and maintain this market value”. Although SLVs fluctuate from year to year, they tend to increase on average over time, as shown in Figure 1.”

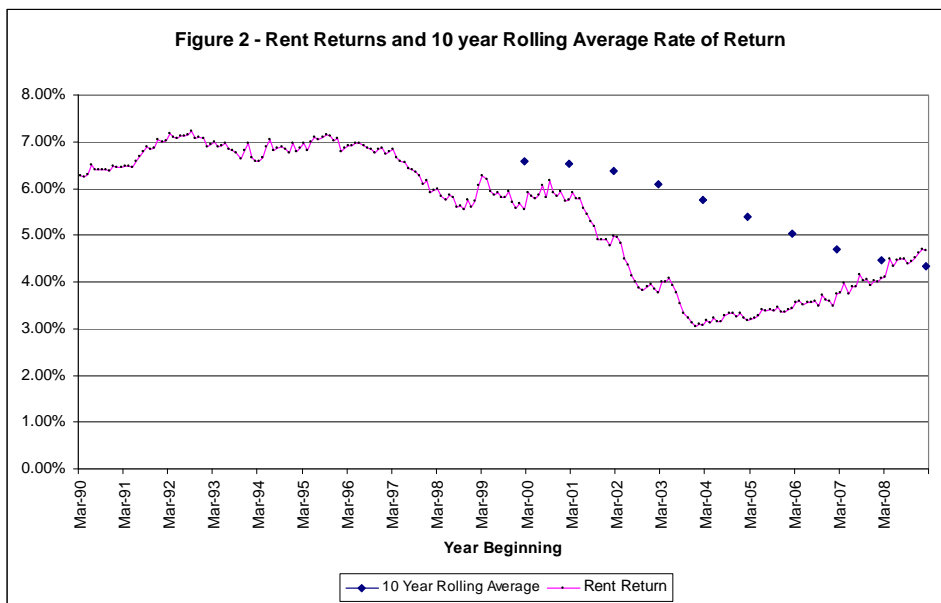
⁹² See SMH 30 November 2009 “Shortage of premises means big rent rises” based on forecasts of BIS Shrapnel.

⁹³ See IPART (2004) “Review into Rentals for Waterfront Tenancies on Crown land in NSW”, p.21.

⁹⁴ IPART (2009) “IPART response to Land Board decision 15 September 2009”.

“By contrast, the return on residential rentals varies from year to year, but there is no tendency for this return either to increase or decrease substantially over time as shown in Figure 2. In this case, a ten year rolling average (shown as diamond points) provides the best indicator of net residential returns and smoothes temporal fluctuations.”

The results of the analysis undertaken in the previous section of our report would not appear to support IPART’s views. Our analysis indicates that the ROR, calculated as a three year or 10-year rolling average, has been declining for some or all of the last ten years (see Table F.1).⁹⁵ Whilst over a longer time period this may even out, over the last 10-years the difference between the 10-year ROR and averages over shorter time horizons has been large. Furthermore, the 10-year 1.5 percentage point fall can have a significant impact on rental calculations, particularly in dollar terms for owners of larger and more expensive properties.



In addition, IPART has indicated that:

“If rates of return were reduced when SLVs increase, as suggested by the Land Board decision, then rental returns would not maintain market value. The alignment of rental returns to reflect and maintain market value was a key objective of IPART’s recommendations.”

As the analysis in Section 5.4 indicates, whilst RORs have tended to fall when SLVs rose in the past, there have been periods when this relationship did not prevail. It is therefore incorrect to presume that an inverse relationship will always apply. It is necessary to examine the data in order to arrive at a supportable conclusion.

This still does not necessarily mean that yearly updates would be the answer. As indicated earlier, our analysis focuses more on ensuring the fairness of the outputs of the rent calculations and less on maintaining in principle relationships between the inputs. Our analysis in Section 5,

⁹⁵ Furthermore, the gap observed between the 10-year rolling average and the single year rate of return each year is part of the reason for our recommendation to reduce the time period for calculating the rate of return to a three-year rolling average, as discussed in Section 6.2.

suggests that the frequency with which RORs are updated should be based on what achieves a predictable and ‘equitable’⁹⁶ rent for all involved over time. Given this, the next section tests different updating options to consider their impact on the rental calculation.

F.4.3 How often the rate of return should it be updated

Table F.6 compares calculated rents for the six years to 2009 using one, three and 10-year ROR averages (using data to the June quarter) and updating periods of one, two, three and five years. The Sydney SD is used as an example so that more years of data can be considered. A number of observations can be made from this table:

- the level of rent calculated can differ substantially when using either the single year, three-year or 10-year ROR (as established in Section F.2). The 10-year ROR yielded the highest rents for the overall period but with the single year average providing the highest rents in 2008 and 2009 yet the lowest in 2004 and 2005;
- if the ROR is updated each year, then the change in rents is the largest for the single year average, with the 10-year average having the least volatility (as established in Section F.2); and
- when the ROR is updated at either two, three or five year intervals, there tends to be large step changes in the rent calculated.

On balance, the table shows that the 10-year average updated annually and the three-year average updated every three years provide the least volatility. However, the 10-year rolling average updated annual provides a constant decrease in calculated rents over the period which would appear to be unrealistic. Furthermore, whilst the 3-year average updated every three years provides a stable result, this could likely be just a result of the data over this period. There would not appear to be any particular reason why a 3-year average updated every three years is more stable than if it were updated every 2 or 5 years. Given this, the observed does not assist in providing solutions to this issue. However, we address possible solutions in Section 5.5 in the report.

⁹⁶ This is a subjective criteria, however we define equity above as “stakeholders broadly believe that the charge is reasonable when each are paying (and the government on behalf of the community is receiving) a ‘fair’ amount”.

Table F.6 Change in rents based on frequency of updates, and time frame over which RORs are averaged

Period	Net rate of return	Land value estimate	Growth in land value	Rent by frequency with which ROR is updated				Growth in rent by frequency with which ROR is updated			
				Annually	2 years	three years	5 years	Annually	2 years	three years	5 years
One-year rolling average (to the June quarter)											
2004	0.30%	1,000		152	152	152	152				
2005	0.40%	1,102	10.2%	220	167	167	167	45%	10%	10%	10%
2006	0.61%	1,136	3.1%	349	349	172	172	59%	109%	3%	3%
2007	0.80%	1,129	-0.6%	451	347	451	171	29%	-1%	162%	-1%
2008	1.10%	1,139	0.9%	627	627	455	173	39%	81%	1%	1%
2009	1.82%	1,127	-1.1%	1,026	621	450	1,026	64%	-1%	-1%	494%
Three-year rolling average (to the June quarter)											
2004	0.72%	1,000		360	360	360	360				
2005	0.44%	1,102	10.2%	244	397	397	397	-32%	10%	10%	10%
2006	0.44%	1,136	3.1%	249	249	409	409	2%	-37%	3%	3%
2007	0.60%	1,129	-0.6%	341	248	341	406	37%	-1%	-17%	-1%
2008	0.84%	1,139	0.9%	477	477	344	410	40%	93%	1%	1%
2009	1.24%	1,127	-1.1%	699	472	340	699	46%	-1%	-1%	70%
10-year rolling average (to the June quarter)											
2004	1.78%	1,000		891	891	891	891				
2005	1.55%	1,102	10.2%	856	982	982	982	-4%	10%	10%	10%
2006	1.35%	1,136	3.1%	765	765	1,012	1,012	-11%	-22%	3%	3%
2007	1.18%	1,129	-0.6%	668	760	668	1,006	-13%	-1%	-34%	-1%
2008	1.08%	1,139	0.9%	612	612	674	1,015	-8%	-19%	1%	1%
2009	1.05%	1,127	-1.1%	591	606	667	591	-3%	-1%	-1%	-42%

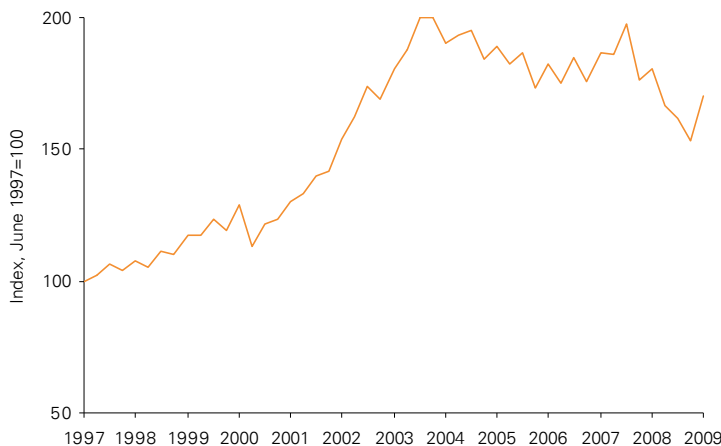
F.5 Method of adjusting the rate of return from gross to net return

IPART chose to adjust the gross ROR by subtracting an estimate of outgoing costs as a set percentage (see Equation 1). This method of estimating means that the implied nominal value of outgoings varies with median house price movements and the share of total rental that is used to cover outgoings is relatively volatile.

This point is illustrated using data from Housing NSW on the median rent, rental return and median price for the Sydney region. The graph below shows the real growth (abstracting for inflation) in estimated outgoings over the last ten year (based on the assumption that outgoings remain at a constant 2.5 percentage points of the rental return). This is not an unreasonable assumption, given that the main components of outgoings, land tax, council rates and water rates, grow in line with land values.

What is clear is that if outgoings are assumed to be constant at 2.5 percentage points of the rental return, the estimated growth in outgoings would have been significantly higher than inflation, and relatively volatile.

Graph F.22 Growth in, estimated real outgoings (at 2.5 percentage points of the rental return)



Sources: Residex; KPMG estimates

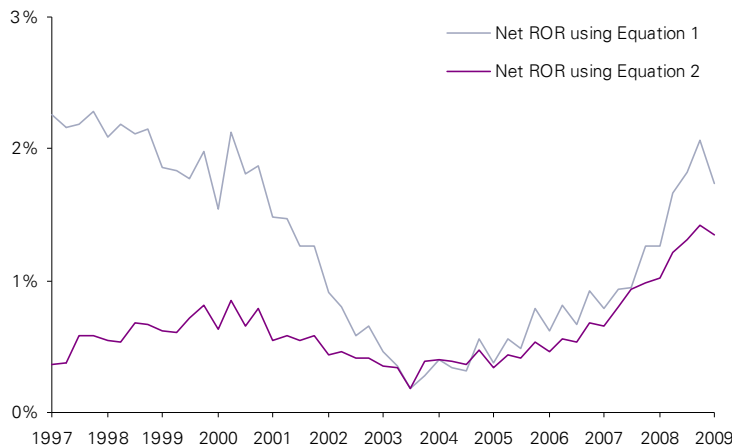
An alternative to the current method (Equation 1) of estimating outgoings and adjusting the ROR from gross to net would be to use an estimate of the outgoings in dollar terms (which would need to be indexed to inflation and periodically reviewed, see Equation 2). It is important to note that both equations use weekly rents, and Equation 2 uses weekly outgoings. In addition, it is important to recognise that Equation 2 links outgoings to changes in CPI, as opposed to changes in house prices (as in Equation 1).

Equation 1 Net rate of return = $\left(\frac{\text{Median rent}}{\text{Median price}} \times \frac{365}{7} \right) - \text{Outgoings}(\%)$

Equation 2 Net rate of return = $\frac{\text{Median rent} - \text{Outgoings}(\$)}{\text{Median price}} \times \frac{365}{7}$

The graph below shows the net ROR using these two different estimation. This graph assumes that the outgoings equivalent to 2.5 per cent in December 2003, and then are adjusted for other periods based on the rate of inflation (adjusted up in subsequent periods, and adjusted down for earlier periods). What it shows is that the ROR is actually lower when a dollar value of outgoings is used, given that house prices have grown significantly faster than CPI over most of the time horizon and in particular prior to 2003.

Graph F.23 Net rate of return using different estimation techniques



Source: ABS (2009) Consumer Price Index; Housing NSW;

Some of the stakeholders have expressed a concern about shifting to a dollar value for calculating outgoings. Specifically, stakeholders have stated that:

“Many of the components (e.g. land tax, council rates, insurance) are percentage based, so it must be on a set percentage base and not a set dollar cost base. Even non percentage based outgoings will vary greatly depending on the size and quality of the rented house, so that a set dollar cost is unworkable. If a set dollar cost was used, it would work in favour of more affluent areas, containing more expensive homes and against less affluent areas, containing cheap homes.”⁹⁷

Egan National Valuers, in the Waterfront Action Group submission to the *Issues Paper* indicated that they believed outgoings should be based on a percentage as is currently the case (Equation 1), as they claimed this is the most reliable method available. The approach Egan used in their analysis was to use a statistical median property value as the basis of the estimates of the cost of outgoings.

Given this analysis, it seems that there is no strong case at this stage to shift to using a dollar value to estimate outgoings. This would be particularly the case if rents were adjusted by CPI each year, outside of the formula, as suggested in the report.

F.6 Other reasons for a discount factor

There may be also one additional consideration when determining discount factor. Some stakeholders indicated that they are already paying additional council rates and land tax as a result of the licence they hold. This is due to the additional value of their land as a result of having the licence. This suggests that the licence holder is being treated as the land owner on one front (and paying land tax and council rates on the Crown land) and as a renter on the other (due to the payment of rent). Whilst this additional revenue is difficult to practically quantify (similar to practically quantifying the value of these licences), some sort of discount may warranted had it not already been taken into account.

That said, this will depend on whether there is a difference in the value of adjoining freehold property as a result of the licence. As discussed in the report, the value of a domestic freehold waterfront property is the value of the unimproved freehold land plus the additional value of the unimproved Crown land that accrues to the freehold land owner as a result of the licence. It seems reasonable to assume that the total value of those values would reflect the net impact of the value of licence to use Crown land, less the net present value of the licence fees. In other words, if the licence fees truly reflect market value, then the market value of the freehold property would be unaltered. If this is the case, then the argument described (concerning double payment) would likely have less merit.

F.7 The case for using more than one discount factor

This section provides the detailed analysis for considering the use of more than one discount factor under different circumstances. Section F.7.1 considers international examples of using different discount factors. Section F.7.2 considers the different types of structures currently on Crown land. Section F.7.3 considers how to categorise these structures.

F.7.1 International examples of applying a discount factor

This section briefly considers international evidence to see what lessons could be drawn regarding how other jurisdictions handle the calculation of rent on government land and the application of a discount factor. In particular KPMG considers the jurisdictions of Washington State (and its consideration of a number of jurisdictions), Canada and Lake Ohio.

In Washington State, the annual rental for water-dependant use leases of state owned aquatic land is: The per unit assessed value of the upland tax parcel, exclusive of improvements, multiplied by the units of lease area multiplied by thirty per cent multiplied by the real ROR. It is $UV \times LA \times .30 \times r = AR$ when expressed as a formula.⁹⁸

Previous lease rate studies in Washington have explored a number approaches and one theme that is often revisited is basing the lease rate on some percentage of the income. None of the reviewed studies recommended using a method other than the existing formula – 30 percent of the upland parcel value multiplied by the real capitalisation rate, which remains in place today. There is no evidence provided as to why a 30 percent discount factor is chosen.

⁹⁸ State of Washington Joint Legislative Audit & Review Committee, Department of Natural Resources, Leasing of State-Owned Aquatic Lands, June 2008, p25.

A report by the State of Washington in 2008 provides a brief analysis of jurisdictions in the US and Canada and how they treat their waterfront properties.⁹⁹ Table F.7 looks at how different jurisdictions set lease rates and demonstrates the many different approaches:

- four jurisdictions set their rates by use category (British Columbia, California, Oregon, Washington);
- Alaska starts with a baseline appraisal rate and negotiates up in price for different uses;
- Florida charges a set rate per square foot of lease area or 6 percent of revenue; and
- British Columbia and Oregon have a minimum rent charge.

⁹⁹ State of Washington Joint Legislative Audit & Review Committee, Review of the Management of State-Owned Aquatic Lands, June 2008.

Table F.7 Processes for setting lease rates in other jurisdictions

Jurisdiction	Process for setting lease rates
Alaska	Rates are set by statute, appraisal, and fair market value. Alaska usually starts with a baseline appraisal rate and then negotiates the price up for different uses.
British Columbia	Rates are set by use. British Columbia may use a zone rate, appraised rate, or a flat rate. They use a flat rate for private moorage and a commercial rate for marinas. They charge a minimum rent and a percentage of land value depending on type of land and type of use.
California	Rental rates are set by use category. There is a discount for continued public access. Every lease is put together on a case by case basis. The goal is to get the best rate for California.
Florida	Florida charges a set rate per square foot of lease area or 6 per cent of revenue. They check slip rates to estimate revenue. They charge the set rate one year ahead of time. If the 6 per cent revenue rate ends up being more, there is a supplemental charge to the licensee.
Oregon	Lease rates are based on use categories and rates outlined in rule. There is a minimum charge and the lease rate increases by 3 per cent each year. Licensees can choose one of three methods: flat rate, percent of gross income, and riparian land value.
Washington	The process for determining water-dependent leases is based on 30 percent of the assessed value of the upland parcel multiplied by the real capitalization rate. Rent for nonwater-dependent uses is the fair market value of the leased lands. Discounts water-dependent use are given for public access.

Source: State of Washington Joint Legislative Audit & Review Committee, Review of the Management of State-Owned Aquatic Lands, June 2008

In Canada more broadly similar discounts can also be found for the Crown land administered in Canada. The vast majority of aquatic lands is owned by the Crown and is mainly administered on a leasehold basis. Aquatic properties require the consideration of several additional factors that are not necessarily relative to upland properties (properties above the mean high water mark). These include:

- accessibility: from the adjacent upland and from the navigable channel;
- depth of water: exposure to currents, waves, wind and draft of vessel;
- period usable: whether it is subject to ice conditions or fluctuations of tide;
- availability of services: municipal regulations, type of shoreline, nature of underwater surface; and
- land use controls: zoning regulations, harbour and navigation regulations.¹⁰⁰

On Lake Erie in Ohio, the annual rental rate for waterfront tenancies is based on the square footage of area occupied by the structure and the proposed use of the structure. Rental rates range from 1 to 4 cents per square foot and a flat annual fee for processing the payment may be charged in addition to the rental rate depending on the type of use. These are as follows:

¹⁰⁰ McConnell, B. Osland, D. 2006, The Appraisal of submerged land, The Canadian Appraiser

- Existing fill – any artificially filled area or filled portion of any area of the territory existing on March 15, 1989, shall be charged \$0.01 per square foot per year for the term of the lease or renewals. This rental rate shall apply only to the use of the filled area as it existed on March 15, 1989. If the licensee or its assigns change the use of the filled area, the rent may be modified to reflect the rent rate in effect for the new use at the time of the change of use.
- Private floating dock – \$50 per year.
- Private structure – \$50 plus \$0.02 per square foot of leased area per year.
- Private erosion control structure – \$50 plus \$0.01 per square foot of leased area for the first year, and \$0.01 per square foot of leased area per year thereafter.
- Semi-private and small commercial facility occupying no more than four acres – \$0.03 per square foot of leased area per year.
- Large facility and an industrial facility – \$0.04 per square foot of the leased area per year.
- Utility – \$500 per year.

The above examples provide useful background information, and confirm that other jurisdictions provide discount factors for similar property, and various discount factors in some cases. This suggests that a precedent does exist for incorporating a discount factor and using different discount factors in different circumstances. However it is unclear how they calculated the discount factors and the logic behind any specific discount factors. Hence other jurisdictions would appear to grapple with the same issues and NSW does.

F.7.2 Types of properties administered by the LPMA

An understanding how to apply discounts for the LPMA, requires an understanding of different properties and their current usage. The LPMA administers the licensing of domestic waterfront tenancies in NSW. Domestic waterfront tenancies are occupancies of an area of public land for private structures, where the land is submerged or reclaimed land. The types of structures that the LPMA manage or have previously managed include:

- **Jetty** – a structure extended into a sea, lake, or river used as a landing wharf
- **Pontoon** – a floating structure used for access to the water that is supported by a jetty and a ramp
- **Walkway** – a path set aside for access to the water or foreshore.
- **Landing/platform** – typically a raised horizontal flat surface, that has steps leading to the water.
- **Ramp** – a slope for launching boats.

- **Reclamation** – an area of submerged Crown land which has been filled or drained for the purposes of reclaiming the land
- **Steps** – steps for the purpose of access to the water
- **Wharf** – a structure built along the foreshore to provide secure moorings, supply, repair and other facilities to boats.
- **Piles** – a group of long timber, steel, or reinforced concrete columns driven into the bed of a water body used for the purposes of a mooring
- **Boatshed** – a building or other structure used for the storage and routine maintenance of a boat or boats and which is associated with private residences
- **Swimming enclosure** – a pool or enclosure within a water body made for the purposes of swimming
- **Slipway** – any structure, usually in the form of two supported parallel rails, on which a wheeled cradle is run to draw a vessel out of the water by means of a powered or manual winch, a block and tackle or the like.
- **Retaining wall** – a wall or embankment to protect the foreshore from erosion or to act as a breakwater
- **Rock armouring** – a structure consisting of a relatively thin layer of lighter crushed rock, rock rubble or coarse gravels placed on the foreshore to protect the foreshore from erosion
- **Access** – A structure for the purpose of access to the water
- **Wet area**
- **Driveway**
- **Deck**¹⁰¹

Table F.8 summarises indicates the number of properties (and share) with broad structure type.

¹⁰¹ We understand that LPMA no longer allows for some of structures to be built on Crown land, however many are still in existence. See LPMA, 2009, Domestic Waterfront Facility Policy

Table F.8 Structures on waterfront properties

Type of structure	Number of properties with structure	Share of total properties*
Land/platform	573	8.4%
Sheds (boats and storage)	1,050	15.3%
Swimming pools	285	4.2%
Residences	123	1.8%
Reclaimed land	2,577	37.7%
Jetty/wharf	5,119	74.8%
Pontoon	2,267	33.1%
Walls (retaining/sea wall)	535	7.8%
Ramps	3,564	52.1%
Slip rails and slipways	1,801	26.3%
Berthing area	820	12.0%

Source: LPMA; KPMG calculations

* Note numbers do not add up to 100% due to the existence of more than one structure per property in many cases

F.7.3 Category groups

The types of structures that the LPMA manage are similar, but grouping them into obvious categories is difficult. Previously, when determining rent of waterfront tenancies, the NSW Government categorised structures into the following groups, and charged a different percentage of rent for each category:¹⁰²

- residence or dwelling;
- boatsheds;
- jetty, pontoon, slips, ramps;
- platform, berthing area;
- reclamation;
- swimming enclosures; and
- other.

¹⁰² Metropolitan land board office, Rental determination of non-commercial waterfront occupations held under permissive occupancy, 1982.

Whilst these categories may be used as a starting point, the LPMA now manages a wider variety of structures. This poses the issue of how the structures can be separated into categories. One idea is to group the structures into two categories. These are structures that:

- provide boat or craft access to the water which may include jetties, wharves, pontoons, ramps, slipways and wet areas; and
- permanently take up physical parcels of land such as boatsheds, swimming enclosures, decks, landings and platforms;

Whilst there are many other structures such as steps, reclamations, retaining walls, rock armouring, piles, walkway and driveways, we understand that most of these are in addition to the above categories and are often developed to assist the public access the Crown land. Furthermore, if structures on the Crown land are from both categories, then for simplicity, it would be easier to assume that the land be charged a rent based on the stricter of the two, being structures that permanently take up physical parcels of the land.

Discussions with the LPMA suggest that these two broad categories capture the majority of the methods in which the land is used and would appear to be logical categories.¹⁰³ Within these categories there is likely to be debate from stakeholders concerning their relative treatment (for example long and short jetties). An overly exhaustive list of categories would create unnecessary administrative costs and thereby fail our “simplicity” criteria. The key is trying to find that balance between the simplicity in identifying and grouping into categories (and its application) compared with improving equity concerning the different methods the land is used.

Whilst a decision may be able to be made concerning on what terms different discount factors should be applied, the size of the discount that should be applied remains unresolved. We are not aware of any data that exists to estimate these discount factors. In the absence of such data, the choice is to apply value judgment in estimating discount rates for different categories, or retain the broad approach recommended by IPART.

KPMG considers that whilst there is a reasonable case for applying differential discount factors, it may be more appropriate to revisit this matter at the more comprehensive review that will be undertaken in 2012. In the meantime, the LPMA should work with the Valuer-General and the associated staff to better understand the data used to calculate PSLVs. This would facilitate a better understanding of the factors impacting PSLVs and hence the conclusions that can be drawn concerning the relative value of the Crown land and its uses with adjoining freehold property.

¹⁰³ Some stakeholders raised concerns about rent being payable on land that was reclaimed several years ago. At times this land was reclaimed to stop foreshore erosion to protect the adjoining waterfront property and often requires ongoing maintenance. Whilst this may be the case, we understand that structures have been built on the Crown land rather than on the adjoining freehold property for this to occur, which makes them subject to a licence and rent. One solution offered by stakeholders would be for the LPMA to sell the Crown land to the adjoining freehold property for a small fee to resolve the issue. This is something for the LPMA and stakeholders to consider separately outside of this review.