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Valuation for Property Tax Purposes

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Introduction

Improving processes for valuing properties lies at the heart of efforts to improve the overall effectiveness of property taxation. Effective property taxation is impossible without efficient property valuation. In practice, however, valuation rolls across most of Africa are incomplete and severely out-of-date, thus dramatically reducing potential property tax yield. This is, at least in part, a function of history: many of the valuation models being used on the continent do not reflect best practices and local learning, but are inherited vestiges of colonial systems that no longer respond adequately to local needs.

The need to modernise is urgent, but progress has been slow. Effective reform needs to consider two broad questions: (i) the extent to which market value or physical attributes of the property should be the basis for valuation; and (ii) which organ of government should be responsible for valuation, and how should it be organised?

Answers to these questions may vary across countries. There is, however, growing agreement that the central need in most countries is to simplify existing valuation processes, to better align them with the realities of undeveloped local property markets and constrained administrative capacity.

Challenges to ensuring effective valuation in Africa

Discussions of property valuation frequently begin from idealised models of property taxation. It is more fruitful, however, to begin from an understanding of the unique challenges of effective valuation in Africa. This can point towards valuation models that are better able to respond to the continent's needs.

Conceptualising and measuring value: in most African contexts property markets are both underdeveloped and opaque, particularly outside of capital cities. This presents challenges that are both practical and conceptual.

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Where property markets are underdeveloped there is little sales data upon which to base valuations. As a result, it is far more difficult to assign accurate property valuations, there is greater scope for abuse, and these valuations are more likely to be contested. In peri-urban or rural areas where property markets are almost non-existent, the idea of a market value may be largely theoretical. There may be no realistic possibility of selling the property owing, for example, to the absence of demand, contested or unclear land titles, or communal land holdings. This may generate sharp disagreements about appropriate valuation for tax purposes and, in some cases, large discrepancies between the notional value of a property and taxpayers' actual ability to pay.

Land titling and questions of ownership: effective property taxation generally requires clarity about property ownership. But this is ambiguous in many countries where land titling is incomplete, highly contested or held by communities.

In urban areas this often reflects multiple competing ownership claims – or the simple absence of ownership in more informal settlements. In areas of communal land ownership this allows for long-term occupation of the land, but not formal ownership. In both cases, taxing the effective occupant of the land is one possible alternative to attempting to tax ownership. However, this raises its own issues: taxing occupation rather than ownership eliminates the possible role of the property tax as a tax on wealth, and potentially disadvantages (generally less wealthy) renters.

Institutional complexity and capacity constraints: many African countries inherited complex institutional structures for property tax administration, which have posed a further barrier to effective implementation. Three issues appear to be relatively common:

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1. Many countries have separate agencies responsible for land titling and land valuation that do not share data effectively, thus complicating valuation efforts.
2. In other areas changes to complex existing valuation methods have been blocked by central valuation departments wedded to existing practices, or by government authorities that have insisted on a narrow interpretation of existing laws (often with roots in the colonial period).
3. In still other areas efforts to expand valuation capacity at the subnational level have sometimes been blocked by central government ministries or valuation departments interested in preserving the status quo.

Valuation models

These challenges to property valuation in Africa have complicated the applicability of models of property taxation inherited from colonial authorities, and have generated growing interest in alternative models.

Market value-based systems are dominant in the former colonial capitals, and in much of Africa. They seek to estimate the price a willing and informed buyer would pay to a willing and informed seller for a given property, or, alternatively, have attempted to estimate the potential rental value of the property.

The principal advantages of such systems are:

- They are often designed to place the highest burden of property tax on the most valuable properties.
- Typically, property markets dictate which properties are most valuable.
- Where property markets are active, property valuations – and property tax revenue – should increase as market prices increase.

However, market value-based systems have frequently proven problematic in Africa:

- In most African cities markets are poorly developed and comparable transactions are hard to find or simply unavailable.
- Even where market transactions occur, the declared prices are often understated to avoid other forms of estate taxes.
- Many countries experience a severe shortage of qualified assessors to handle the number and frequency of valuations needed.
- In the absence of active property markets, valuations are likely to be open to collusion or corruption between assessors and property owners.
- Valuations are more likely to be contested and appealed by taxpayers who have little transparent basis for assessing their fairness.

Surface area-based approaches that use the area of land or buildings to assess the property tax base have, historically, been the main alternative.

Their principal advantages have been that:

- They have a highly transparent and easy-to-verify taxable base.
- The property's taxable base can be easily updated using a standard formula.
- They are generally somewhat equitable, based on the size of land or properties.

These approaches have, however, revealed two principal disadvantages:

- They fail to adequately incorporate qualitative aspects of buildings, which significantly limits fairness. This is a special concern outside large cities, where older and unimproved homes are often large in surface area or sit on large plots.
- Administrative authorities are responsible for adjusting valuations upwards over time to ensure revenue buoyancy. These annual adjustments may be politically difficult.

While market value- and surface area-based valuations remain dominant in Africa, governments are increasingly considering *simplified hybrid methods* designed to be both equitable and practically feasible. These hybrids begin from a surface area-based approach, but add locational and qualitative factors (class, zones and construction).

Hybrid methods used in some countries are designed to generate *presumptive market values*. In Cameroon, for example, the property's presumptive value is obtained by multiplying the surface area by clear reference prices provided for in regulation (classified according to municipality, zones therein and attributes of the property). This may not perfectly reflect market values, but values should be generally progressive – while providing a predictable and common point of reference for all stakeholders.

A points-based system has been adopted at the local level in countries like Sierra Leone and Malawi. This method assigns points based on the surface area of the land and buildings, while additional points are awarded for positive features or deducted for negative features of the property (e.g. neighbourhood, construction materials, access to services and quality of finishing). Its key difference and advantage, relative to presumptive market values, is that instead of relying on reference regulatory prices, the method correlates to market value as a reasonability test.

For all the methods above there is a question of whether valuation should be of land, buildings or both, and whether it should cover only *de jure* (titled) or also *de facto* (untitled) ownership of property. In some cases governments may require separate valuations of land and buildings, and may tax only titled property. Here, however, experience seems clear: a single valuation that incorporates both land and buildings, and covers all forms of ownership, is likely to be most administratively acceptable.

Centralised or decentralised?[1]

Africa's systems equally vary in the extent to which valuation is centralised or decentralised. In practice centralisation appears to remain the dominant model, particularly in francophone countries, though some anglophone countries have assessments decentralised to municipalities.

Centralised valuation is typically operationalised by the creation of a central valuation agency, or in some cases is simply left to the tax administration.

The principal advantages of centralised management of valuation systems are that:

- It ensures the use of harmonised methods of assessing properties throughout a country. Greater technical capacity can be accessed for complex market value-based systems.
- It may reduce the risk of collusion with local property owners.

The principal disadvantages are threefold:

- Actual assessment of properties is geographically removed from municipal authorities, resulting in relatively high costs to: (a) update and maintain the tax register, (b) accept and deal with tax appeals, (c) issue and deliver rate demand notices in a timely manner, and (d) challenge defaulters to comply.
- Central valuation officers may have weak incentives overall. Given that property taxes are a tiny share of central revenue, the lack of accountability to local authorities may reduce pressure for adequate valuation.
- Countries reliant on property valuation by central government authorities almost universally appear to have a severe shortage of trained staff relative to the number of properties to be valued.

The alternative *decentralised model* is typically found in anglophone Africa, where the English colonial system treated property taxes as the responsibility of subnational governments. Its principal advantages are that:

- It is pragmatic and cost-effective compared to the centralised model.
- Localisation is consistent with objectives of building local governance capacity, and can facilitate appeals and transparency.
- Since communities are closely involved in valuation and decision-making, it may secure legitimacy for subnational government action and may contribute to increased property tax yields.

The principal disadvantages are threefold:

[1] Goodfellow, T. (2017) *Central-Local Government Roles and Relationships in Property Taxation*, ICTD Summary Brief 12, Brighton: IDS.

- The concentration of administrative components at the local level could facilitate collusion and rent-seeking.
- Lack of capacity at the local level for more complex valuation methods/processes is a concern – though it may be significantly reduced with simpler methods.
- There may be a lack of consistency in property valuations across different local government areas.

The right answer is likely to depend on the details of local context, while hybrid methods are possible. The most urgent need is for careful consideration of relevant trade-offs where reform is being contemplated.

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Valuation officers, tax authorities, private contractors and self-assessment

Irrespective of which level of government is responsible, African countries equally vary in the specific actors who carry out valuation efforts. There are four primary alternatives:

1. *Valuation officers:* particularly in anglophone countries, it is common to have distinct valuation departments assess property values, and then pass these to tax agencies for billing and collection.
   a. This model has the advantage of separating valuation from tax collection, potentially ensuring consistency and reducing scope for coercion and abuse.
   b. However, without the need to collect revenue, these officers may have insufficient incentives to ensure that property valuations are complete and up-to-date.
2. *Tax authorities:* an alternative is for valuation of properties to be carried out by tax agencies themselves. This appears to be the case in many francophone countries, and where local governments control property taxation.
   a. Tax authorities are likely to have clearer incentives for ensuring that valuation is up to date in order to maximise revenue collection.
   b. However, close links between valuation and revenue collection may risk greater corruption and abuse.
3. *Private contractors:* where valuation by government officers has proven ineffective over time, some local governments have begun to turn to private contractors.
   a. This may be an effective short-term strategy: clear contracts and the enforcement thereof can generate effective incentives for expanded valuation efforts.
   b. In the long term, reliance on private contracts can pose substantial risks, including: (i) reducing the scope for public appeals, (ii) contracting problems that increase cost or reduce effectiveness, owing to either corruption or simple errors, (iii) a failure to develop long-term capacity and ownership within local governments, and (iv) weakening links of accountability between governments and citizens.

4. *Self-assessment:* finally, Rwanda has been the most notable adopter of a model of self-assessment, in which property owners are required to declare property values, surface area or key characteristics for automated valuation to the tax authorities.
    a. Self-assessment can dramatically reduce time, costs and the logistical challenges of current valuation systems.
    b. However, meaningful self-assessment depends on an effective (and equitably applied) audit of declared values and publicised enforcement of those who report false data, potentially achievable through simplified valuation criteria to use as a reasonability test. In many contexts such effective audit does not yet appear to exist.

The way forward

Recent experience in several countries highlights the advantages of simplified valuation systems, along with some possible benefits of local administration. Successful cases have proven to be low cost and responsive to local needs, while providing hands-on training to local valuation officers. Effective IT systems have, in turn, helped to manage the risks of local collusion and political capture.[2]

However, while these simplified methods have proven relatively effective, they pose a key challenge: in countries where central governments have historically retained and exercised full authority, it might not be realistic or practical to envisage a quick and complete reversal of existing systems. Instead, hybrid strategies may be possible: combining the accumulated expertise of central agencies with the practical benefits of simplification, while exploring diverse modes of collaboration between central and local authorities.[3]

“In these situations, progressive medium-term steps could be taken towards instituting valuation arrangements that are more effective and better accommodate local realities.”

In these situations, progressive medium-term steps could be taken towards instituting valuation arrangements that are more effective and better accommodate local realities. The following objectives could be helpful guides in selecting the right combination of method(s) and model(s) – though the right answer in any given country will reflect local circumstances.

1. *Consider simplifying valuation methods in order to reduce costs and increase coverage:* a consistent message from recent research and experience is that market-based valuation is costly and impractical in most African contexts – and certainly outside larger cities. There is a strong argument for considering the use of presumptive market value- or points-based systems – either as a primary form of valuation, or as a means to audit self-assessed values. Even where reliance on market-based

[2] Prichard, W. and Fish, P. (2017) *Strengthening IT Systems for Property Tax Reform*, ICTD Summary Brief 11, Brighton: IDS.

[3] Goodfellow, T. (2017) *Central-Local Government Roles and Relationships in Property Taxation*, ICTD Summary Brief 12, Brighton: IDS.

valuation is maintained as a first option, it may be possible to use these other models as alternative options available to local authorities where market-based valuations are out of date, non-existent or otherwise problematic.

2. *Explore the benefits of localising valuation activities – or hybrid arrangements:* the primary drawback of centralised valuation – particularly outside capital cities – has been high costs, large geographic distances and a lack of sufficiently trained valuation officers. Increased reliance on locally trained officials, employing simplified valuation methods, has demonstrated significant potential. This can be achieved through full decentralisation of responsibility to local governments, but equally through partnerships: the establishment of local valuation offices under central direction, or locally recruited valuation teams supported by central valuation officers. Where simplified methods are employed local staff may not be valuation officers as such, but merely collect key property data. Central government valuation officers would, for example, retain responsibility for valuing smaller numbers of properties, in order to establish reference prices to translate basic property characteristics into taxable values.

3. *Understand institutional barriers to improved valuation:* in many countries there is an obvious mismatch between the small number of valuation officers and large numbers of properties awaiting valuation. But reform has been slow. Governments should seek to understand the barriers to expanded recruitment – and expand flexibility where existing practices are failing. Thus, for example, small changes to legislation may facilitate more appropriate methods. Alternatively, flexibility in interpreting existing legislation may allow authorities to experiment with new approaches where valuations are out of date.

4. *Exploit the potential of automated valuation tools:* new IT tools hold substantial potential to facilitate more effective and transparent valuation.[4] This is particularly true when paired with simplified valuation methods, as basic and observable property characteristics can be automatically translated into property valuations and bills – and/or used to cross-check the accuracy of existing valuations.

5. *Strengthen appeals in order to build credibility and compliance:* an often-overlooked concern is that taxpayers should be able to: (a) appreciate the reasons underpinning their valuation, and (b) understand why their neighbours are assessed higher or lower. This can build credibility, particularly if they can appeal what they feel are invalid valuations. Simplified valuation methods can be very helpful as they are based on observable characteristics, and are thus more transparent and easier to understand.

6. *The absolute value of each property is less important than the relative value:* the majority of taxpayers are likely to be most interested in knowing that they are paying as much as a similar houseowner, or less than a larger or superior house. This is particularly true in Africa, where limited property markets, unclear ownership and communal landholding may make it easier to assess relative values than actual market values. As such, methods that can apply consistent and comparable

[4] Prichard, W. and Fish, P. (2017) *Strengthening IT Systems for Property Tax Reform*, ICTD Summary Brief 11, Brighton: IDS.

valuations within different localities are critical to perceptions of fairness.

7. *Be sensitive to local conditions, understandings and constraints:* even when employing simplified valuation systems, different localities may present unique needs. Where ownership is contested or unclear, alternative strategies for applying the tax – for example, on occupants or landlords – need to be locally acceptable. The features of land and property that create perceived value may differ across localities, and valuation formulas should reflect this. Where property markets are almost non-existent, or property is held communally, the basis and rationale for property taxes need to be communicated appropriately – and allowance made where tax rates are inconsistent with ability to pay.

Further reading

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Credits

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