Property Valuation and Taxation in ECA

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What did we do?

• Joint work on Property Valuation and Taxation with FAO and the Lithuanian Centre of Registers

• Funded by ECA Public Financial Management (PFM) Trust Fund

• Case studies: on Albania, Kazakhstan, Lithuania, Moldova, Poland, Serbia, Slovenia, Turkey, and the Netherlands (comparison case)

• Countries at different stages in developing their property valuation and taxation systems

How and why to establish efficient property valuation systems for multiple uses, including value-based property taxation?
Why does this matter?

- **Rapid urbanization** has put additional pressures on city financing and fiscal sustainability
  - Today, over 4 billion people or 50% of the world population live in urban areas; by 2045, the number of people living in cities will increase by 1.5 times to 6 billion, adding 2 billion more urban residents.

- Moreover, fulfilling the **Sustainable Development Goals** will require an additional USD 2.5 trillion each year for the next 15 years, putting the spotlight on cities’ ability to raise revenues and improve service delivery.

- **Growing interest** in Eastern Europe and Central Asian countries to increase local revenues, enhance state land management, and define state asset values accurately
  - Belarus, Kyrgyz Republic, Moldova, Serbia, Uzbekistan
  - Other regions: Lebanon... Indonesia... Pakistan...

- **Local governments** increasingly rely on **property taxes as revenue source**
  - 100% of total local taxes in the case of the UK, Ireland, Australia
  - An average of 37.7% for high income countries;
  - An average of 35.5% for middle income countries, Manila City (54%), Cape Town (41.1%)
Merits of recurrent value-based property taxes

- Suitability as local taxes as fall on **immobile assets**
- **Reduces local governments’ dependency** on inter-governmental fiscal transfers at a time when many governments are under fiscal strain
- **Increases accountability** of local governments to citizens
- Helps to **counter tax avoidance** by multi-national companies and tax erosion resulting from **globalization**
- **Reduces reliance** on income, profits and sales taxes and social security contributions and their **distorting effects** on work and investment
- Taxes wealth – helps **promote equity** in taxation by reducing tax burden on low income groups from income and sales taxes
- Helps counter **inter-generational** wealth inequalities
Recurrent Property Tax – the under-utilized tax

- Two main types of property tax:
  - Recurrent – levied annually
  - Sporadic – levied when there is a trigger event e.g., sale of property, mortgage, change in town planning consent, death of owner

- Recurrent property taxes are widespread – Almy (2014) identified 166 countries using them

- But lightly used
  - Arithmetic average percentage of Gross Domestic Product raised by recurrent property taxes for the EU is just 0.8 percent.
  - Norregaard (2013) found that the proportion of GDP generated in this way by middle and low-income countries was only 0.4 percent.
...in both OECD countries...

OECD Countries Recurrent Taxes as % of GDP

Case study countries represented by green bars.
Source: OECD (2015) Dataset Revenue Statistics – Comparative tables. 4100 Recurrent taxes on immovable property,
...and low- and middle-income countries...
So why is a tax with so many merits lightly used?

- Public and political opposition to property taxes – lack of champions in government
- Need to put in place preconditions for successful tax reform – valuation infrastructure, property registration, quality of price data, improvements in tax collection
- Many recurrent property taxes not levied on market value. Common alternatives:
  - Area sometimes modified by coefficients but these do not accurately reflect market values – sets an effective ceiling on tax rates
  - Depreciated historic cost or book value of buildings – not what prudent owners would spend today and use of artificial depreciation rates rather than obsolescence based on market value
  - “Cadastre” values set by mass valuation systems that do not reflect market values
  - Out of date values rather than regular revaluations
What is needed as the base?

- Need for **comprehensive register** of properties – issues of systematic first registration, informality, voluntary registration of transfers, registration of leases

- Register of **3-dimensional rights** and not just parcels or buildings – units of occupation rather than ownership, ancillary spaces and rights

- **Characteristics and attributes** of properties are recorded – unreliable and inconsistent data can be declared about **property characteristics** e.g. size – footprint rather than floor area, terraces excluded

- Maintenance of currency of register – use of **automatic updating and data capture** where possible
Why ECA is Interesting?

World Bank Support on Land in ECA

- Recognition of **property rights**
- **Land reforms** and anti-discrimination
- **First registration** and cadastral mapping
- Digitalization and **web-based services**
- Land and geospatial records and **eGovernance**
- Sustainable **business models** for land agencies

KYRGYZ REPUBLIC

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Leading Land Registration Region

Doing Business 2016; Registering Property

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<thead>
<tr>
<th>Rank</th>
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<td>1</td>
<td>New Zealand</td>
<td>11</td>
<td>United Arab Emirates</td>
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<td>10</td>
<td>Sweden</td>
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<td>Finland</td>
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MACEDONIA

Dramatic Growth in Mortgages in Kyrgyzstan

Number of Transactions

- Without Project Scenario (Estimates)
- With Project Scenario (Actuals)

- Year 2005: 42,116
- Year 2010: 148,659
- Year 2015: 163,186
Why is ECA Ready?

Interlinked Data and Services in Macedonia

Mass Valuation System in Slovenia

www.katastar.gov.mk
Valuation infrastructure

- Adoption of **internationally-recognized valuation standards** and creation of a **valuation profession**:
  - Valuation terminology and valuation framework
  - Valuation methodologies
  - Measurement standards
  - Qualifications and education of valuers
  - Enforceable ethical standards and codes of professional conduct
  - Licensing of valuers or requirement to use valuers who follow valuation standards
Importance of quality of price data

- Need for sources of **accurate price data** as basis for estimating market prices e.g. declared prices on registration

- Need for **efficient and transparent markets** with adequate numbers of transactions of each type of property

- Problem of **tax evasion and declaration of false prices** – incentives to cheat to avoid taxes and fees

- **Weak tax enforcement** mechanisms undermine data quality

- If declared transactions prices **unreliable** can use alternative eg asking prices, mortgage valuations, databases of valuers and realtors

- Development of **sales price, rental and mortgage valuation registers** to improve transparency and reliability of data
Importance of mass valuation

- Large number of properties to be valued over a short period of time – viable only with automated valuation systems rather than individual valuations

- Use of standardized procedures, common data and statistical testing of models – helps achieve consistency

- Requires coordination of different agencies and their data

- Low cost per valuation but high fixed costs of establishing the system

- Tackles capacity problems. Reduces requirements for scarce skilled valuers who can be used more effectively e.g. appeals, valuing properties for which automated valuation not possible
Automated Mass Valuation System (A –Z)

- Develop a digital data infrastructure, promoting data sharing and usage
- Develop efficient valuation models e.g. with only 5 parameters (location, type of use, age, area, facilities) that can lead to about 80% accuracy
- Develop valuation models for different types of properties and surroundings that result in the most accurate, cost-effective results
- Apply valuation zoning within these models to segment the most valuable areas from the least valuable ones
- Invest in ICT application for automated mass valuation systems
- In terms of the overall structure, begin with a centralized system with appropriate capacity investments (note: this is sensitive to the existing level of decentralization)
- Later, determine whether or not to decentralize the mass valuation system depending on appropriate capacity at the local government level
What Are the Best Practices?

- Ensure that property rights are defined and marketable
- Create complete and accurate land and property records
- Collect and publish transaction price information
- Establish national valuation standards in line with internationally-recognized standards
- Determine appropriate qualifications, experience and ethical standards for valuers
- Establish licensing for valuers
- Understand and assess the economic and social impacts of application of market values to property taxes
How to Go About It?

- Make valuation rolls comprehensive
- Improve billing and collection
- Develop valuation infrastructure
- Incentivize and enforce market transparency
- Apply mass valuation systems for efficiency
- Introduce regular revaluations
- Introduce necessary social safeguards and transition

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<th>Downtown Commercial Properties</th>
<th>Rural Agricultural Land</th>
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<td>Capture high-value properties with least cost and time spent first</td>
<td>Worry about low-value properties needing high cost and time last</td>
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Multiple use of mass valuations

**Uses** include:
- sporadic tax assessments
- compulsory purchase
- valuing state land, restitution, land consolidation
- water and flood protection charges,
- setting rents for social housing, reviews of bank capital adequacy, avoidance of mortgage fraud, eligibility for social security

**Caveats** include:
- mass valuations may not accurately value individual properties
- Embody assumptions about basis of value
- Compulsory acquisition particularly problematic
Quality of tax collection!

- Quality of billing systems
- Variability in collection rates and in enforcement systems
- Differences between household and business collection rates
- Overcoming culture of non-payment
- Transparency issues: are the elites paying their taxes?
Overcoming resistance to property taxes

- **Poland and Slovenia** have developed mass valuation systems that have not been implemented.

- **Moldova** mass valuation of urban properties but not rural housing or bare land or public properties and no revaluations of urban ones.

- Assessing **residential properties technically easier** but likely to be more resistance than to taxing commercial properties – business don’t have votes!

- Property taxes **highly visible** as are local services.

- **Lack of effective champions** in government – local taxes, different administrative systems from other taxes, failure to recognise the financial interdependence of levels of government.

- **Lack of political willingness** to tax wealth and to stand up to losers from property taxes.

- Need to make the **link** between sound national finances, sound local finances and the quality of local public services.
Thank You!