FACTSHEET

Local Government Revenue Initiative

Addis Tax Initiative

Workshop 1: Strategies for Cost-Effective Property Valuation Systems

Property valuation is a crucial step in ensuring effective property tax administration. Using various methods, property assessment aims to approximate the market value of properties for taxation purposes. Experience from various low-income countries shows that property valuation is frequently highly ineffective. In some cases countries rely on expert methodologies that fail due to their complexity, high costs, limited market data and limited capacity. In other cases, those limitations lead to reliance on simple area-based or zonal systems that generate substantial inequities. As a result, local governments use incomplete, out-of-date, inaccurate or regressive property tax rolls. What are the key challenges with valuation? How can governments implement cost-effective valuation systems? Presentations from the first ATI & LoGRI workshop highlighted key valuation challenges and strategies and opportunities for reform with examples from Benin, Sierra Leone, and Togo.

View from the top of Moses Mabhida Stadium, South Africa

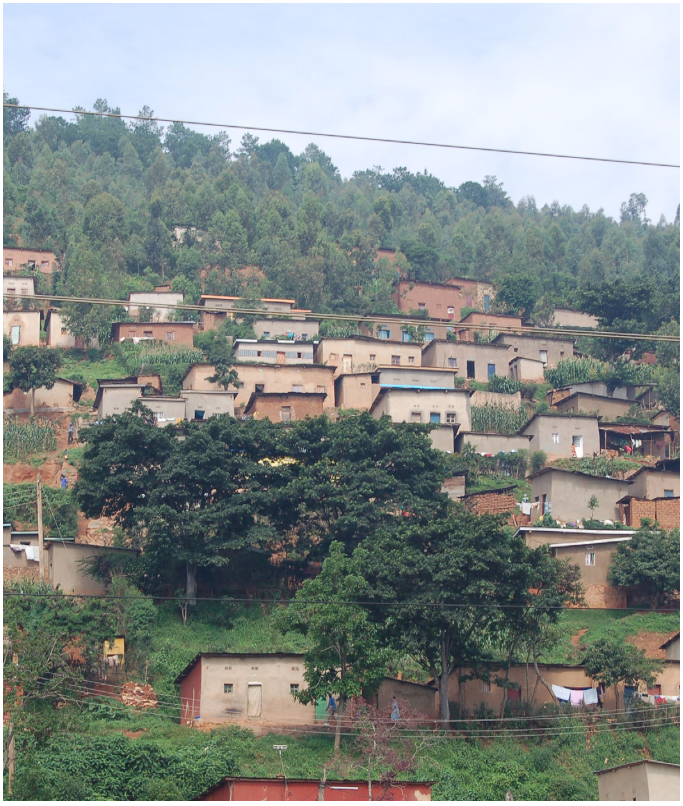
Key Challenges Associated with Property Valuation Systems

1. **Ineffective valuation systems hinder the possibility of unlocking revenue potential:** Property valuation, an essential process mandated by law, is intended to occur at regular intervals. However, in reality, numerous lower-income countries face significant challenges in fulfilling this requirement due to financial constraints and limited resources. As a result, they often resort to using outdated valuation rolls that fail to reflect the true potential of property tax. Thus, recurrent property taxes are a largely untapped source of revenue, accounting for less than 0.08% of GDP in Benin, about 0.03% of GDP in Togo, and less than 0.01% of GDP in Freetown before the 2019 reform.

2. **Valuation methodologies are overly simple and unfair or heavily reliant on difficult to obtain market data, and thus prone to error or abuse:** Valuation systems exhibit significant variation across different countries, with diverse methodologies (area-based, market-based (capital value or rental value of properties) or simplified methods) employed to assess the value of properties. These methods may involve tax authorities or local governments conducting evaluations, or they may rely on a self-declaration process where taxpayers are entrusted with declaring the value of their assets directly to the local government or tax authorities. Property valuation in Benin and Togo is to be based on the rental value of the property. However, market data are difficult to obtain, and rental values difficult to determine in the absence of a fixed asset market developed with proper recording. The result in Togo is, in practice, reliance on zonal values by property type, but which sacrifice equity. Similarly, Freetown (before the reform) relied on estimate of market values, but, owing to similar challenges of estimating market values was de facto employing an adjusted area-based system, leading to significant inequity and severe undervaluation of the most valuable properties, because the methodology did not account for a number of major determinants of value, such as location and building quality.

3. **Valuation methods lack transparency and allow for significant subjectivity, making them prone to corruption and collusion:** The absence of transparency and clarity in the valuation process not only undermines the integrity of the taxation system but also breeds a sense of mistrust among citizens. When valuation is conducted manually, the one-on-one interaction between valuers and property owners can lead to subjective valuation due to collusion and corruption and the motivation to lower the values of properties. Additionally, when valuation systems are complex, this leads to a limited comprehension by taxpayers of how their tax liabilities are determined. In Benin, Togo and Freetown (before the reform) the property valuation process was less transparent, leading to inconsistencies and subjective determination of property values while opening the door to corruption and collusion. Low transparency and poor understanding of the process for determining tax liabilities amplify the lack of confidence in the fairness of the system while discouraging tax compliance.

4. **Insufficient technological and technical capacity as well as limited human resources:** Limited human resources, and partial adoption of information technology (IT) systems, make property valuation difficult to implement in practice.
   - **In Freetown,** prior to the 2019 reform, the valuation process was carried out entirely manually, where valuers will assess one property at a time and manually calculate the values of properties, and thus taking a much longer time to complete the valuation and challenges with data management.
   - **In Togo,** the tax authority lacks enough cadaster inspectors, GIS specialists, and software and topographic equipment to work on property valuation.



Houses on a hill slope, Rwanda

Strategies and Experiences for Reforming Property Valuation Systems

There is now a widespread agreement among governments and experts that existing valuation systems require major reforms. Property valuation proves to be most effective when the methodology used for assessing the values of all assessable properties adheres to key principles: consistency, transparency, progressivity, and equity in tax distribution. This effectiveness can be achieved through two fundamental components. The first component is horizontal equity: ensuring that properties with similar characteristics and attributes are valued consistently. This approach promotes fairness and prevents any discriminatory treatment among property owners with similar types of properties. The second component is vertical equity: valuing more valuable properties at higher assessed values, while less valuable properties are assessed at lower values. This progressive approach ensures that those with higher-value properties contribute proportionally more to the tax distribution, while those with lower-value properties shoulder a relatively lighter burden. Freetown reformed its property tax system, with that system now being extended to other cities. *The focus was on the adoption of a simplified, cost-effective and transparent valuation system to increase fairness, progressivity, equity and affordability.* Both Togo and Benin plan to improve their systems with similar objectives in mind.

Presentations during the workshop highlighted experiences with different approaches.

1. **Freetown:** In 2018, with strong political will, the city of Freetown embarked on an ambitious property tax reform at both policy and administrative levels. The city adopted a points-based valuation system that is more efficient and cost-effective. The methodology consists of valuing properties using a combination of information about the property size, location and easily observable physical characteristics. The methodology is simpler to administer and more transparent, making it easier for taxpayers to understand than the expert-led valuation. That reform effort, which has enjoyed significant success, is now being extended to Kenema, and then to all other cities in the country. [1]

[1] Detailed information about the points-based methodology implemented in Freetown can be found here: https://www.ictd.ac/publication/simplifying-property-tax-administration-africa-piloting-points-based-valuation-freetown-sierra-leone/ Also presentation by Nicholas Orgeira Pillai and Evan Trowbridge gives a good overview of key features of this methodology and impact. Paul Fish also wrote a practical guide on implementing the points-based and publication can be found here: https://www.ictd.ac/publication/practical-guidance-note-training-manual-for-implementing-property-tax-reform-with-a-points-based-valuation/

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2. **Benin and Togo:** Tax authorities are seeking to adopt simplified and more transparent valuation methodologies to strengthen equity and fairness, taxpayers' understanding and compliance. Reforms are still in the development phase.

    - In Benin, the tax administration has initiated a reform process with support from experts to easily determine the rental value of properties. This is done by categorising municipalities into groups and zones based on their level of development, followed by the identification of rental values, which are determined based on the cost associated with building a property. It is assumed that this approach will guarantee fairness and equity in taxation.

    - In Togo, the tax authority implemented tariff zones in the capital Lomé followed in each zone by the classification of properties by categories that are defined based on characteristics such as building types, location etc. However, this falls short in some areas, as the categories may not fully reflect differences in property characteristics and therefore fail to achieve a more progressive and accurate assessment of rental values. More efforts are underway to design a fair and more optimal valuation system.

Key Takeaways

1. Progressive, simple and transparent systems: Property valuation systems in the majority of lower-income countries are not very effective. Reform strategies are geared towards re-designing systems that (i) can deliver progressivity and equity in taxation, (ii) are simple enough to administer and (iii) transparent enough to reduce collusion and abuse.

2. Transparency and precision: By fostering transparency and precision in property valuation methodologies, governments can increase trust and tax compliance among taxpayers. Transparency could be achieved by providing clear explanations of the valuation criteria, the data sources used, and the calculations involved to allow taxpayers to better understand how their property values are determined. Precision ensures that valuations are conducted with accuracy and reliability by employing up-to-date data, and easy-to-implement valuation techniques to prevent over- or under-valuation of properties.

3. Strengthening capacity: Strengthening local governments' technical, technological and resource capacities can enable a regular updating of property valuation rolls and, ultimately, a more accurate assessment of the potential of property tax revenues.

4. Political support for reform: Political support plays a pivotal role in driving the crucial reform aimed at enhancing valuation methods and rectifying the inherent shortcomings of existing systems, which are often entrenched and challenging to change. The successful implementation of these reforms demands robust technical, technological, and financial capacity. Therefore, garnering strong political support for change becomes indispensable in propelling the necessary investments, improvements and sustainability of the reform.

Aerial view of Johannesburg, South Africa

For more information on the topic and the country experiences presented during this workshop, you can find the article on the first two workshops here: https://www.addistaxinitiative.net/news/ati-logri-workshop-series-policy-design-effective-property-taxation and (most of) the presentations here: https://www.addistaxinitiative.net/resource/2023-workshop-logri-presentations.