CONFERENCE CONCLUSIONS

Conference on Property Valuation and Taxation for Fiscal Sustainability and Improved Governance in Europe and Central Asia, 3 – 5 June 2015, Vilnius, Lithuania.

The Conference on Property Valuation and Taxation for Fiscal Sustainability and Improved Local Governance in Europe and Central Asia (ECA) organized by the World Bank, FAO and the Lithuanian Centre of Registers took place in Vilnius, Lithuania between 3 and 5 June 2015. It was attended by 120 people from 26 countries including Albania, Azerbaijan, Belarus, Croatia, Czech Republic, Estonia, FYR Macedonia, Georgia, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Serbia, Slovakia, Slovenia, and Turkey. The participants came from a wide variety of backgrounds including national cadastres and land registries, land boards, tax authorities, ministries of finance, ministries of justice, professional bodies, valuation companies, universities, think tanks and aid agencies. The presentations, case studies and supplementary material can be accessed at: http://www.registrucentras.lt/PropertyValuationConference/conf_material.php

Mr Juozas Bernatonis, the Minister of Justice for the Republic of Lithuania, opened the conference, noting the importance of stimulating discussion on property taxation, which can provide a stable source of finance in a globalized world and for local government. Mr Bernatonis welcomed the fact that the Lithuanian system was being recognized as a leading example, being both modern and transparent, and as an early adopter of mass valuation based on digital data.

Deputy Speaker of the Seimas (Parliament), Chair of its European Affairs Committee and former Prime Minister, Mr Gediminas Kirkilas drew attention to Lithuania’s position in the World Bank Doing Business rankings, noting also the importance of property taxation for resolving budgetary problems.

Dr Jorge Muñoz, spoke on behalf of the World Bank, which has supported over 40 projects, worth more than $1.2 billion, in the ECA region between 1994 and 2014. Of these, 21 were stand-alone land projects. In addition to this, there are 16 projects being implemented at present and more projects are in the pipeline. These projects show high economic rates of return. The initial focus was in land and property registration and they have achieved significant reductions in registration times and costs. The current focus is on national spatial data infrastructure, property valuation and taxation, land agency corporate governance, business climate improvement, management of state lands and assets, and electronic government and services.

Dr Paul Munro-Faure, on behalf of FAO, drew attention to the importance of valuation for informing better decision-making and the role of recurrent annual taxes in producing fair and efficient taxation. The ECA region had seen remarkable technical developments and progress. Current requests for technical support are in the areas of taxation, compensation and land management. Dr Munro-Faure drew attention to the importance of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security, which provide a framework for policies on property taxation, valuation, compensation and land management that is based on international law and internationally-endorsed declarations.

Mr Kęstutis Sabaliauskas, on behalf of the Lithuanian State Enterprise’s Centre of Registers, noted that the issues around of property taxation were not only technical but also political because of their impact on citizens.
Case studies

The World Bank commissioned nine case studies on property taxation and valuation from countries in the ECA Region. These were presented to the Conference. The case studies were designed to offer a representative sample of the progress that has been made in the region, ranging from countries that are just starting to develop value-based property taxation systems to those with well-developed systems. One country from Western Europe was included for comparison.

Albania. Albania has experienced rapid growth of its urban areas after the speedy privatization of property and government decentralization. Although there have been advances in institutional development, the cities are dominated by informal, though not inadequate, development. There is therefore a need to finance infrastructure. Although there are recurrent property taxes on buildings and agricultural land, the revenue from these is low relative to the GDP. The taxes form only a small proportion of local government revenue. Urban land is untaxed and property taxes are primarily based on size or area (instead of value). Land prices are estimated annually by the Agency for Compensation and Restitution of Properties, and these prices can be used to derive approximate market values. A public awareness campaign is needed to inform citizens of the link between taxation and public services – and the implicit benefits of levying property taxes. While tax collection can be a problem, some municipalities have made good progress here.

Serbia. The annual property tax in Serbia provides revenue for municipalities but it raises relatively little as a proportion of GDP. Municipalities have therefore been dependent on government grants and revenue sharing of national taxes, which ended in 2014. Municipalities have also made use of various fees and charges as “shadow” property taxes. These have had a distorting effect on business and have now largely ended. Municipalities are responsible for property tax assessment and collection, which raises concerns about the capacity of some of them to accomplish this and the potential that each municipality will use its own valuation methodology. Not all properties appear in the property tax rolls. In 2014 the government began to develop a valuation infrastructure and a planned World Bank project will improve the property data in the cadastre. Serbia has developed a sales price register with data collected from notaries, which can form the basis for mass valuation and the development of value zones.

Turkey. Turkey has experienced rapid growth in its urban population. It has an active property market with over two million transactions each year. Although city, town and district municipalities are able to raise revenue through property taxes, the metropolitan municipalities are not, which raises questions about how the infrastructure needed for Turkey’s rapidly growing cities will be financed. Valuation for the annual property tax is undertaken by local commissions, who may or may not be qualified valuers. Land valuations are mainly based on area and building valuations on replacement cost. Turkey has an efficient valuation infrastructure put in place by the Capital Markets Board. This is used for mortgage valuations but it is not for property taxation. The Turkish Cadastre (TKGM) carried out two pilot studies in 2013–14 to examine the potential for developing mass valuation systems. One of the principal problems is finding suitable price data. The case studies noted that real prices were 2 or 3 times higher than declared prices. There is a significant divergence between the nominal and effective property tax rates. Further
development work is planned to use mortgage data to improve the quality of price information and additional pilot studies focusing on commercial property.

Kazakhstan. Kazakhstan has agricultural and urban land taxes and a tax on buildings belonging to individuals, which are all based on area. It also has taxes on assets belonging to legal entities, which is based on the book value. Area-based assessments are adjusted by a complex system of coefficients that are unrelated to local property markets. Work has been undertaken to develop a valuation infrastructure. A pilot study of apartments in Astana, has examined the potential for using mass valuation. The price data was taken from declared prices, which are thought to be reliable because of low registration fees and an absence of property transfer taxes. A good correlation coefficient was achieved for the model. The study showed the importance of data cleaning to remove transactions with implausible variables and where the transactions may not be at “arm’s length”. The study also identified a need to support recorded information on properties with external inspections. Poland. Poland passed legislation to enable mass valuation in 2005. Detailed directions on the preparation of mass valuation had been prepared by the Surveyor General in 2002. A variety of local government bodies are involved in the process. Data comes from the cadastre and land register, the price register, building documentation, taxpayer surveys, and field inspections and surveys. The cadastral value should be the market value, as defined by international standards, on the taxation date. Poland has a well-developed valuation infrastructure with standards that conform to international standards. It has a system by which valuers are licensed. However, implementation of the mass valuation system has been stopped for political reasons.

Moldova. Moldova has, in part, replaced the largely area-based system that was introduced after widespread property privatization with a new value-based property tax system that uses mass valuation. The new system is applied to apartments and dwelling houses in urban areas as well as to commercial and industrial property. The old system remains in use for agricultural land, rural dwellings and special properties, such as infrastructure networks. The tax base for the new system is the market value of the property in its current use. There are significant tax exemptions, including state and municipal property, as well as a 15 percent discount for anyone who pays their tax early. These exemptions and discounts reduce the potential tax yield even though tax collection rates are high. Assessment is undertaken by cadastral authorities using the sales comparison, income capitalization or depreciated replacement cost methods. Various issues have arisen with the tax system, particularly the lack of regular revaluations and the fact that the new tax has not been extended into rural areas in what is substantially a rural country. Doubts have also been raised over whether illegal construction is being identified and whether price information is accurate, given the high property transfer tax. The municipalities are the beneficiaries of improvements to the mass valuation system but the cost is borne by central government, which has been reluctant to allocate resources.

Slovenia. Slovenia carried out major reforms to its land administration after it gained its independence, including privatization of property and the establishment of a land registration and cadastral system. Experiments with collecting real estate transaction data led to the creation of a mass valuation system. A valuation infrastructure was developed that included valuation standards based on international practices and valuer certification. Mass valuation uses sales comparison, income capitalization and depreciated replacement cost approaches. There were proposals that mass valuation should result in a value-based property tax. The first experimental mass valuations were completed in 2010 and valuation models were
approved by the government in 2012. A generalized market value became publicly available. The intention was to conduct revaluations every four years with intermediate indexation. The Real Estate Tax Act was adopted in 2013 in spite of strong opposition but has subsequently been ruled unconstitutional by the Constitutional Court, which means that this new tax system cannot at present be implemented.

**Lithuania.** Lithuania developed a valuation infrastructure between 1994 and 1996, and established a legal basis for valuation, valuation standards, and valuer qualifications. The unified real property cadastre and register was established in 1997. Initially, property taxation was based on nominal values for land and book or replacement cost values for buildings. A mass valuation system was developed after 2000 within an environment in which there was already a valuation infrastructure and the land registry was collecting transaction prices. The transaction prices are believed to be reasonably accurate because of low registration fees and the influence of capital gains tax – under-declaring transaction prices can result in future capital gains tax liabilities. The property tax was extended in 2006 and now applies not only to legal persons but also to buildings other than dwellings owned by natural persons. Higher value dwellings were included from 2013. Market value based land tax was also introduced in 2013. Property tax assessment and collection is undertaken centrally, although revenues go to local authorities. Sales comparison, income and cost models are used with model-building being dispersed to local offices. Tax revenues are low relative to GDP and the land and buildings taxes are not yet integrated. Assessed values of land and buildings are used not only for taxation but also for other public needs.

**The Netherlands.** The Netherlands has a well-developed system of value-based property taxation and has been included in the study so that it can be compared with those case studies from Central and Eastern Europe, and Central Asia. The Netherlands has a relatively large number of local governments, each responsible for property tax assessment. Valuation can be undertaken by the municipality itself, outsourced to private companies, or undertaken by a shared service centre. Revaluation is undertaken annually, which reduces the number of objections to tax assessments. The Netherlands Council for Real Estate Assessment ensures quality control by setting guidelines, undertaking audits, and publishing results. Residential valuations are based on comparable sales; non-residential valuations use income capitalisation or the depreciated replacement cost. In the Netherlands there are established valuation standards and qualifications for valuers. Qualitative data about materials and maintenance is used alongside cadastral data and data about buildings. Information on property is also collected from the internet, for example, from sales particulars. The subsequent assessments are used in property taxation and for other purposes, including the prevention of mortgage fraud and setting maximum rents for social housing.

Further, the case studies were explored in four discussion groups: (1) Land Register and Spatial Data; (2) Mass Valuation Systems Operations; (3) Property Tax System Operations; and (4) Non-Taxation Uses of Mass Valuation. In addition, the discussion groups were able to visit the Centre of Registers, Swedbank and the Lithuanian Association of Banks to hear a range of presentations about the Lithuanian cadastre, land registry mass valuation, and property tax systems.
Conclusions

This conference showed that apart from the important property taxation application, mass valuation systems have the potential to be used for a multitude of purposes (such as for state asset valuation and management, state audits and compensation), providing that there are safeguards to ensure the proper basis for valuations used in each case. Valuations for different purposes can require a different basis for value. There is the potential to **recover costs** and **generate income** by providing services to professionals and third parties like banks and other financial institutions and making mass valuation systems and the data produced available. Mass valuation data has an **economic value for businesses** and this should be recognized. Cost recovery can be employed and contributions sought to maintain and develop the systems. Public and political acceptance of mass valuation can come from recognizing the **potential social and public benefits** it offers, for example in improving the management of state land and by increasing stability of the banking system by making up-to-date valuations of collaterals. **Multiple uses enable best value** to be obtained from systems that are expensive to set up and maintain.

One of the main conclusions from this conference was that the development of **value-based recurrent property taxes** can help address some of the imbalances in taxation in the ECA region. There is a problem of **dependence on sales taxes**, such as value added tax (VAT) and excise duties. These can be regressive in their impact and distort long-term GDP per capita. Furthermore, the practice of financing local governments from **intergovernmental fiscal transfers**, grants and revenue-sharing agreements can be unsustainable. It is desirable that local governments have their own sources of revenue and property taxes have long been recognized for being characteristically suitable as local taxes because they fall on **immobile assets** within each jurisdiction. High rates of property transfer taxes can discourage registration, discourage people from seeking planning and building consents, and result in illegal and informal development. They can also result in the **under-declaration of sales prices**, which undermines the revenue from such taxes and the accuracy of information about the property market. Property taxes can be part of a policy to produce a more progressive tax system. Taxing the wealthy on their wealth shifts the **tax burden** to those who can most afford it and can also reduce the burden of taxation on incomes and profits. In any tax reform there are inevitably winners and losers. It is important to determine who these are and to recognize that the losers are likely to articulate their potential losses and lobby to have these mitigated, whereas the potential winners may be unorganized and less vocal.

There are important issues of balance in property taxation. There is a need to balance the tax burden between **residential and commercial taxpayers**, particularly as residential property taxpayers are also voters whereas legal entities are not. The issues of **affordability** in property taxes need to be recognized too, particularly the problems facing groups that are asset-rich but cash-poor. In the transition countries of the ECA region many of those now in possession of property assets may not have acquired them through conventional purchases but through **privatization** at nominal prices or through **restitution**. Many households and small businesses may find themselves in possession of assets whose value exceeds what they might be able to purchase out of their lifetime incomes.

Often these countries have **extensive exemptions** from property taxes. There is a question of how these exemptions are determined and how extensive they should be since exemptions inevitably increase the tax burden on those who are not entitled to them. In particular, there is a question of whether national, regional and local governments should be exempt from
paying property taxes on their assets. Whilst it might seem counter-intuitive for bodies that receive tax revenues to also pay tax, exempting public bodies increases the tax burden on the private sector and households, discourages public bodies from making the most economical use of their assets, and crowds out the private sector because the public sector can capitalize their property tax exemptions and are therefore able to pay higher bid prices for assets. In many countries, transparency could be improved over the way tax rates are set, how assessments are undertaken, and how the revenues from property taxes are to be used. Property taxation requires the coming together of many agencies of government, including national cadastres and land registries, tax authorities, municipalities, and national banks (as the regulators of mortgage markets). The best way to achieve cooperation between these bodies is an issue that each country has to address.

Various prerequisites for sustainable property taxation were identified in the case studies:

• the underpinnings of good laws that satisfy constitutional requirements and that enjoy public support;
• transparent and efficient land and property markets where prices are openly and freely negotiated;
• reliable ways of collecting accurate data on transactions, including sales prices and rents;
• reliable systems for recording properties in tax rolls;
• reliable systems for collecting billed taxes and the existence of collection-led strategies;
• a valuation infrastructure that comprises valuation standards, requires qualifications and professional education of valuers, and sets ethical standards to be followed in valuation and tax assessment;
• good communications and a strategy for explaining to citizens, politicians and other stakeholders the purpose of mass valuation and property taxation, the connection between taxes and public expenditure, and to persuade citizens of the fairness of taxes and tax policies;
• property taxes along with tax assessment and collection systems that meet the requirements for good governance.

In the discussion, a number of best practices in property taxation were recognized. Effective land and property registration systems are needed to provide a database for property taxes. These systems need to be comprehensive in coverage, updated in real-time, and to be automatically linked to databases that record changes, for example, in addresses, construction consents and town planning consents. Cadastres need to record buildings and not just land parcels. They should record three-dimensional rights and not just the footprints of buildings so that the sub-divisions of buildings into different units of ownership and occupancy can be identified. For example, a cadastre recording a shopping centre or mall needs to identify the different retail units, or in an office block identify who occupies each floor and how the floors may be sub-divided between occupiers, and for apartment blocks, the various housing units they contain. Low fees and taxes encourage registration and the declaration of accurate prices, whereas high fees and taxes are likely to discourage registration and encourage false price declarations. Making false price declarations needs to be discouraged not just by penalties, which may be unenforceable, but also through the use of capital gains taxes (these tax the difference between the declared purchase price and the eventual sales price, encouraging more accurate declarations) and by linking of mortgage valuations and assessments of collateral with the declared price. The development of transaction and sales
price registers are a valuable tool, which should be, preferably, linked to notaries and sales contracts.

The development of value-based property taxes requires multivariate skills in valuation, statistics, economics, geo-spatial and GIS, and computing to be utilised in order to create mass valuation models. Adopting advances in technology aids this development and modelling and supports the synergy of the databases, textual and spatial data, and 3-D analytical functions. The use of these techniques and systems requires the development of capacity, both technical and human, and adequate resources on a continuing basis.

The development of efficient, effective and fair property taxes is something that takes time to achieve. It is likely that countries will go through several iterations before they have in place property taxes that work well and are accepted by the majority of taxpayers. Property tax reforms need to be undertaken in stages and a number of intermediate steps may have to be taken before value-based taxes can be fully implemented. Work may need to be done to make tax rolls comprehensive and billing systems function effectively, to ensure that there is an efficient valuation infrastructure with technical and ethical standards, valuer education and qualifications, and a transparent property market with effective systems for reporting transactions and prices. A well-functioning value-based property tax system indicates that the whole property market and the systems necessary for its efficient functioning are working well. Any country thinking of introducing value-based property taxation needs to develop a roadmap of the steps required to achieve this and to adopt a realistic timescale over which these can be implemented. One does not need to start with a fully functioning property tax system from the outset but rather look towards developing one in stages over time.

One of the key conclusions to emerge from the conference discussions was that property taxation is not just, or even primarily, a technical issue. The impact it has on citizens and businesses makes it a sensitive issue that produces significant reactions from the population. It is proper, under these circumstances that democratically-elected politicians concern themselves with property tax policy and its implementation, and that proposals should have a sound constitutional basis. Public perception and political ramifications are very important. Property taxation may be met with more hostility than taxes that impose higher burdens on the public, such as income or sales taxes. The experiences of Poland and Slovenia, where well-designed systems have not been implemented because of political and public reactions to them, and of Moldova, where the government has not extended the new property tax into rural areas or been willing to fund further development work, illustrate the sensitivity surrounding property taxation.

There is a need for a tax system that the population recognizes as being fair. There is also a need to educate the public on the balance between taxation and public expenditure, in particular that higher levels of public expenditure necessitate increases in taxation. The case most needs to be made in the transition economies of the ECA region where citizens are now faced with explicit taxes to fund public expenditure; under central planning systems the ways in which public expenditure was financed were not transparent. An important component in the development of value-based property taxation is the use of public awareness campaigns to educate the population about how the tax revenues are going to be used and the reasons these burdens are being imposed. Wider initiatives on governance may be required along with increased transparency in public finances if the public are to be persuaded that taxes are being levied for their benefit.
The central issue here is political willingness to legislate on property taxation. Even where legislation does exist, there is the question of whether, at a national and local level, there is the political willingness to implement them. Property taxes are wealth taxes. Implicit here are questions over whether there is willingness from governments to challenge powerful and well-resourced groups in the national interest by imposing property taxes that fall on them. Are there champions for property tax reform in governments? In particular, do Ministries of Finance understand property taxes and their potential, taking into account the specialist techniques and institutions that are involved in levying them, techniques and institutions which may be outside the general experience of those more accustomed to administering income, sales and profits taxes?

In keeping with the idea that property taxation is not just a technical matter but requires public acceptance, there is a need for transparency, which should include the dissemination of assessed values via the internet. Easily understandable information for taxpayers on valuation methodologies and models is essential for ensuring public understanding of the system. Separation of assessment and collection functions can improve the quality of governance and the reliability of assessments because those undertaking assessment have no direct financial interest in the outcome and may, as a result, be more objective. Property tax systems should be subject to continuous auditing and improvement in the quality of the underlying data. Quality management systems can help to continuously improve the way property tax systems function. The use of metrics enables the performance of property tax systems to be monitored and the accuracy of assessments to be evaluated.

It should be acknowledged that mass valuation and effective property taxation are long-term goals. Best practices need to be shared and co-operation can facilitate the exchange of knowledge. Several iterations may be required to achieve well-developed systems and practices and to find the best approach for a particular country. Costs fall over time as capacity increases with progress on, what is, a learning curve. The countries that have made the most use of property taxes took time to evolve their systems, which are far from perfect.

The way ahead

The case studies and the wider conference discussions have raised many important issues about property valuation and taxation that should be brought to the attention of a wider audience. Property valuation and taxation are two of the areas specifically addressed in the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests (in sections 18 and 19) and also make an important contribution to other areas covered in the Voluntary Guidelines, such as expropriation and compensation, restitution and land consolidation.

FAO has undertaken to publish versions of the nine case studies in a special themed edition of its Land Tenure Journal (see http://www.fao.org/hr/tenure/land-tenure-journal/index.php/LTJ/issue/archive). LTJ is a journal with a wide international readership and, as a refereed journal, the quality of articles is high. The case studies will be accompanied by a cover paper setting them and their conclusions in context and deriving the lessons of wider applicability. The themed edition of the Land Tenure Journal is expected to be published later this year.
There will be a Best Practices publication from the World Bank and FAO drawing together the lessons learned. This is expected to be in draft form in the early autumn 2015 and those attending the Vilnius conference will be invited to comment on and review the draft. The intention is that there will also be some form of e-learning outcome.

A paper on the project will be presented at the International Association of Assessment Officers conference, which is taking place in Indianapolis in September 2015.

The work undertaken to date has focused on the Europe and Central Asia Region. However, the issues raised in the case studies and by the project as a whole are not only relevant to this region. Nor are the lessons learned only applicable in the ECA region or to transition economies. It is hoped that in the future this work and the case-study/conference format can be replicated in other regions of the world, such as Africa, where valuation and taxation are two major outstanding issues that require urgent attention and where lessons can be learned from similar initiatives supported by the World Bank and FAO.

The World Bank/FAO is exploring several options to disseminate the work from this project and to develop it further. Stay tuned!

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