

Building Market-based (Ad Valorem) Property Assessment Capacity—International Challenges and Opportunities in Developing Countries

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This article explores the contribution of ad valorem property assessment and taxation as a function of a modern land administration system (LAS), with particular focus on its relevance in helping address some of the challenges faced by developing countries—countries that need infrastructure for fair and equitable taxation, better land use control, efficient property and credit markets, and access to international capital markets. Such capacity is essential in formalized property markets to fund local infrastructure to improve quality of life and to encourage domestic as well as foreign direct investment in land, which is necessary to economic growth and wealth creation.

In the past two decades, forces such as globalization, securitization of real estate, growth in capital markets, climate change, changing demographics, and enabling technology continue to drive the need for sophisticated national concepts in integrated land management. At one end of the spectrum, in North America and Europe, elements of land administration systems (including property valuation) are being integrated into seamless business lines, where clients have focused access to a suite of property related services to inform their decisions in changing domestic and global property markets. Real estate service providers are shifting their business models through strategic thinking and business planning, force field analysis, reengineered business processes for cross-functional operations, and improved service delivery, supported by development of international professional standards.

At the other end, developing countries in Southeast Asia and Africa are receiving advice through internationally funded projects on establishing the basic operation of an LAS and are being introduced to the fundamentals for functional property markets. Of the 227 world nations, approximately 40 can claim to have formal comprehensive property markets (Williamson and Wallace 2007).

Emerging property markets, including examples like Thailand and India, represent investor-driven demand for valuation services. A less-well-represented need for valuation information to support decision making lies in the demand by multinationals and developed countries for large land tracts in developing and least developed countries in Africa, Latin America and South East Asia. The demand has recently escalated due to factors such as climate change, climate obligations, political support for agro-fuels, and trade liberalization—factors that were exacerbated by 2007-2008 food crises and the financial crisis of 2008. Although information on individual transactions is scanty, their scope is evident in the single deals that have been as large as 1.3 million hectares (GTZ 2009). Such land concession decisions, made in the absence of functional land administration systems (providing for secure land tenure, land use control and land valuation information) can increase conflict and make long-term impact evaluation difficult.

Foreign direct investment (FDI)—in land—has received little attention in the past. (FDI in land is such a new phenomenon that

it is only beginning to be defined. An early definition by GTZ, GmbH [2009] is,

FDI in land by a foreign company or state is based on a lasting interest in taking control over land use rights. The transaction includes either rights of land-use or land-ownership. The land-use rights are generally valid for a limited period and can possibly be extended.)

However, according to a recent German study, the magnitude and relevance of FDI in land is growing rapidly. And while FDI in land in developing countries brings many benefits to those countries, the commercial pressures on land are worldwide and not always positive, particularly where policy and decision makers do not have the benefit of information from efficient LAS that exist in formalized property markets (International Land Coalition, undated).

Property assessment organizations and their members can contribute significantly to fill the decision-making information vacuum in developing countries and consequently benefit their own professional development.

Valuation: A Pillar in Land Administration

A land administration framework helps provide assessment experts with context for relating their services to those of other professionals in aiding policy and decision makers in achieving multidimensional goals in sustainable development (i.e., economic, social, environmental, and cultural). As figure 1 indicates, valuation is an essential pillar of the modern LAS—whether in developed or developing countries. LAS provide the framework for policy implementation and support the information transparency that is necessary to efficient land markets and to effective property taxation by drawing together the four land administration functions of land tenure, land value, land use, and land development (Enemark 2005). Professional assessors should understand how these functions are interrelated in mature property markets that are prevalent in developed countries. However, it is important to distinguish the paradigm shifts that are occurring in modern LAS in developed countries in response to global markets from the challenges to development of

effective LAS in developing countries. The latter is the focus of this article, which considers how implementation of market-based property assessment systems can aid broad policy objectives and contribute to shifting from informal to formal property markets in developing countries.

Baseline: Moving from Informal to Formal Property Markets in Developing Countries

There is evidence of significant correlation between development of effective LAS and the transition from informal to formal property markets (Ballard 2008, 139). Before considering the interaction between LAS and property markets, it is helpful to consider what informal markets are and why their transition to formal property markets is generally desirable.

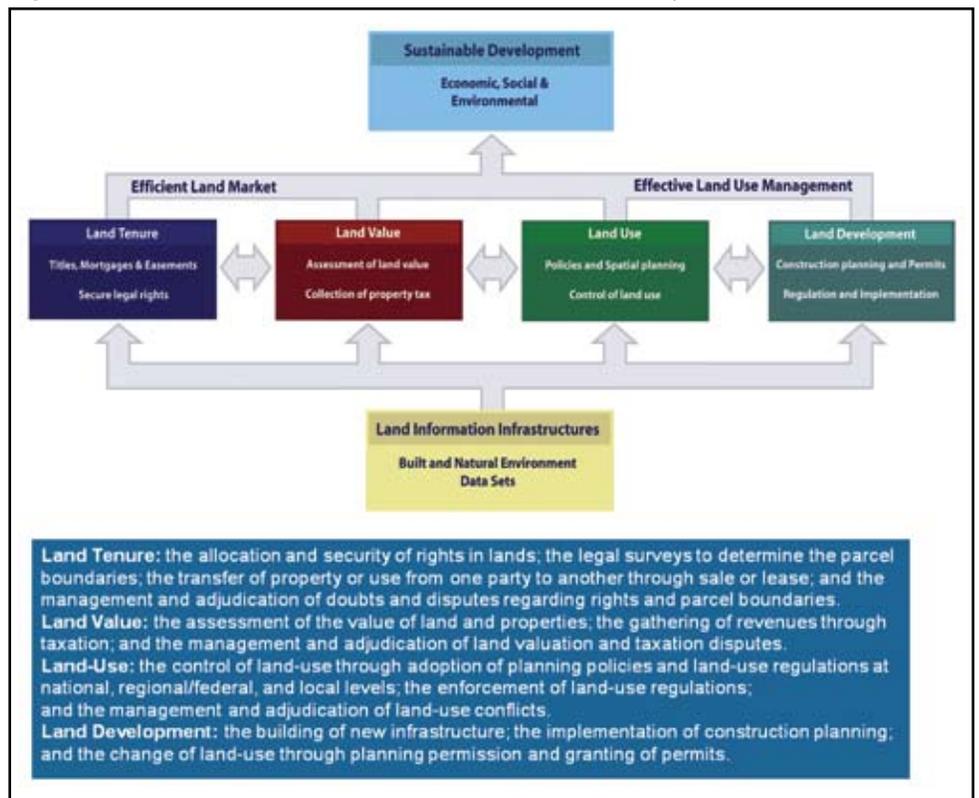
Property markets can be described as more or less formal according by the extent to which market activities are authorized and supported by government. (Williamson and Wallace, 2007).

Informal markets have met local needs in the local property markets of some countries for many years. People have

relied on local authorities to recognize and validate local land transactions and transfers (Ballard 2008, 140). Where there was limited need for regional or international property markets, people tended to place greater trust in local officials and locally held records. Where public trust in central governments is not strong and where corruption is commonplace, it is seen as preferable to trust local people. In addition, there can be resistance to a movement toward formal markets in countries in which central governments introduce onerous property transaction fees and taxes, especially when people do not understand the broader benefits associated with a formal property market.

Over time, as property markets mature in developing countries, there is the risk that locally approved transfers will not be recognized by the government or by the courts. But governments need to tread carefully in the transition to more formal markets to avoid exacerbating land tenure security problems, thereby potentially increasing conflict, as evidenced by the eviction of land occupiers in some developing countries. Early projects focused

Figure 1. Global View of a Modern Land Administration System





on land titling have shown benefits such as improved access to credit, increased land values and tax collection, but, as discussed later, such narrowly focused projects are not sufficient for the development of comprehensive, formalized property markets.

Formal property markets are defined by the degree to which governments authorize and support the LAS. Thus, a key to success is that governments understand their role in reducing corruption and building public trust in land administration to achieve the desired benefits (e.g., increased tax revenue, land use control, wealth creation, economic growth, and access to international capital markets).

Williamson and Wallace (2007) have described a five-stage evolutionary model whereby property markets advance from bureaucratic land distribution (e.g., in post-war periods) to complex commodities markets, designed to help guide development of LAS, including valuation services, to promote a country's economic development (Figure 2). Advancing through each stage—from land trading (stage 3), through land market (stage 4) to complex commodities market (stage 5)—requires greater sophistication and professional support from valuation professionals to develop the investor and

public confidence necessary to success in international market places.

Helping Build Capacity in the Shift from Informal to Formal Property Markets

Also key to the successful transition to formalized property markets is the ability of developing countries to draw on the collaborative experience and expertise of professional practitioners to expedite the transition, which has taken decades to accomplish in developed countries. Building capacity in the LAS of developing countries may be seen as an important part of the infrastructure needed to support global markets and to address growing global challenges, such as climate obligations, recent food shortage crises, or the 2008 financial crisis. In other words, building LAS capacity is broadly beneficial and presents professional growth opportunities for LAS (including assessment) service providers and their professional organizations as they continually adjust to increasingly global business and market environments.

Successful transition to formal property markets requires building capacity among local property market participants, that is, creating an awareness of the risks related to their informal markets and an under-

standing of mechanisms and advantages related to market formalization. A key focus in successful transition to formal property markets is development of the cognitive capacity of property market participants. As Williamson and Wallace (2007) state, “any transitional process needs to start much more with people’s attitudes, than with building GIS and titling programs.”

As assessors know, people don’t own land; they own rights to land, commonly referred to as a *bundle of rights*. Those rights, in whatever form they take, require valuation to facilitate decision making in formal markets. So, bridging the gap from informal to formal property markets necessary to effective participation in regional or global markets (advancing from stage 3 to stage 5 in Figure 2) therefore means building the capacity to understand and benefit from abstract notions about the *bundle of rights*. Creative *unbundling* and commoditization, supported within an LAS frame, need to be enabled by building the capacity of market participants to understand the nature of the commodities. This capacity is critical to shifting local market participants from simple land trading to creating and marketing abstract land rights and complex commodities related to property. Williamson and Wallace (2007) illustrate the complementary nature of cognitive capacity with the three pillars, which have traditionally been understood to support land markets (Figure 3).

Understanding the maturity of the current property market is important to the successful development and implementation of an ad valorem property assessment system in the developing country, particularly because market maturity levels can differ significantly from region to region, for example, among urban, peri-urban, and rural areas. However, a careful balance must be maintained between building investor confidence through advancing maturity of property markets and national versus local policy objectives of improved land use control, reduced land speculation, and revenue generation to fund infrastructure (*The Economist* 2010). Familiarity with the policy- and decision-making environment and an understanding of the country and regional cultures

Figure 2. Evolutionary Stages to Support Formal Property Markets

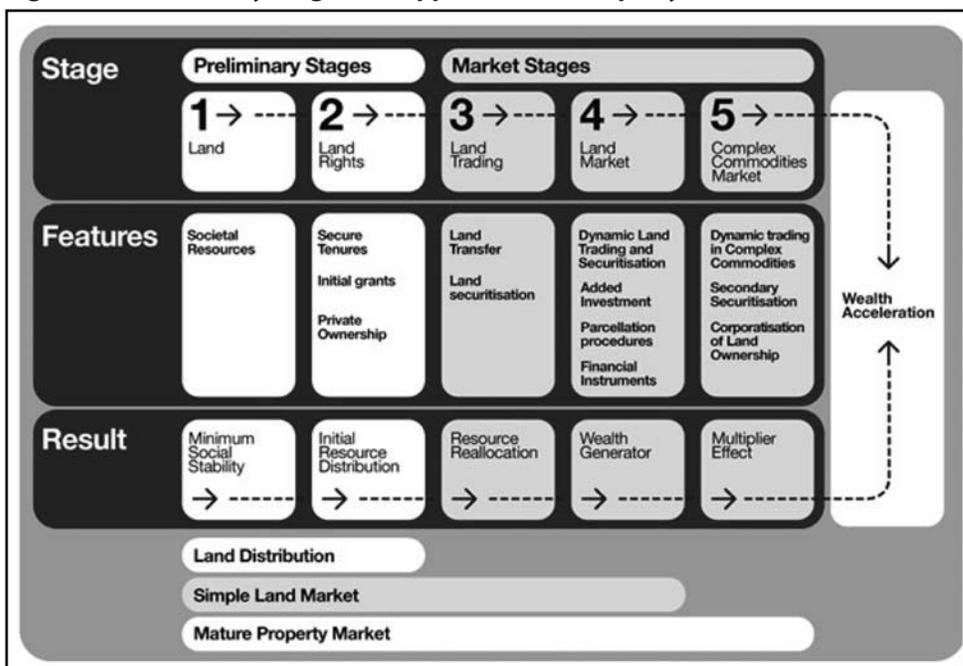
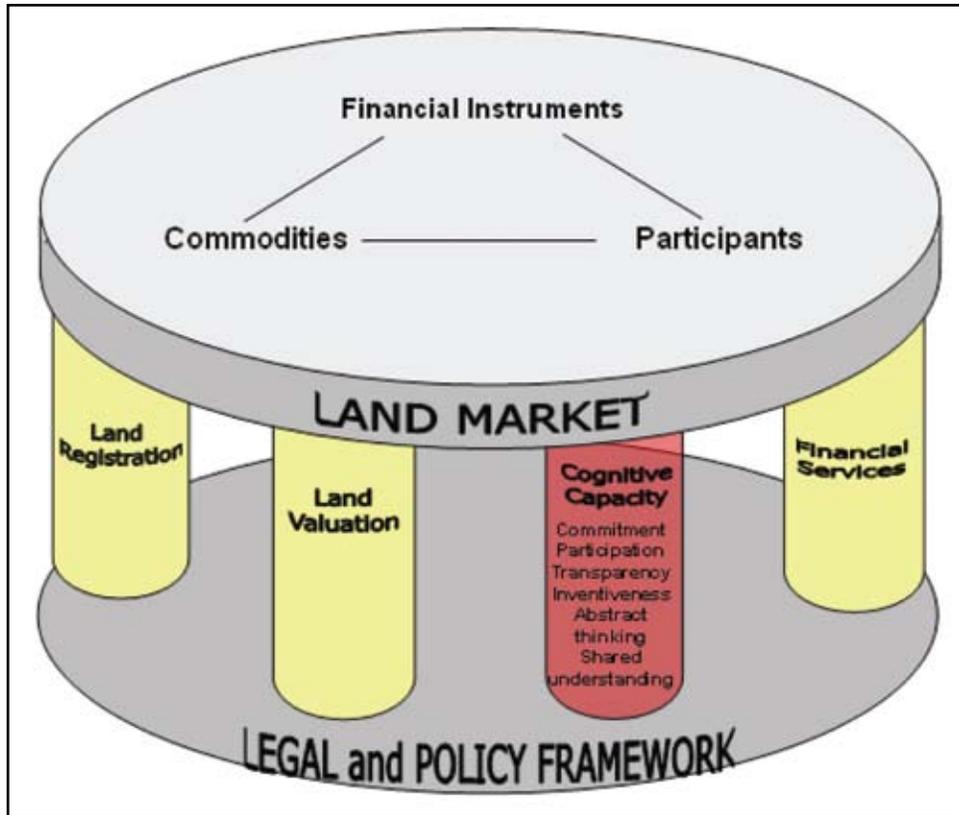


Figure 2. Land Market Supports and Enablers



are necessary prerequisites to success in any effort to build property assessment and taxation capacity.

Helping Build Capacity through a Market-Based (Ad Valorem) Property Assessment System

How can professional assessors assist in building property assessment capacity in an emerging economy or developing country? In support of land valuation policy objectives, can implementing an ad valorem property assessment system help transition property markets from informal to formal? An affirmative answer to the second question arises out of how the first is answered.

Many interactive elements need to be understood before a market-based property assessment system can be built. And placing those elements in a policy framework, logically organized within an LAS, helps to plan for and deliver success. Although the elements for a property assessment system are reasonably straightforward to set out, their successful implementation can be daunting. For outside advisors, it is important to have a clear understanding of country culture, a specific mandate,

sufficient resources, and, perhaps most importantly, country champion(s) willing to run the gauntlet of change management in challenging environments.

Essentially, the developing country requires a scalable valuation system that can contribute to public and investor confidence while meeting policy requirements, such as for supporting taxation and land use control policies. The valuation system, however, also needs to contribute to an increasing capability to deliver the professional services necessary for the valuation of complex entities such as property-related derivative commodities and *unbundled* land rights. This emphasizes the need for building professional valuation and assessment administration capacity, in tandem with the jurisdiction's responsibility to build infrastructure and engender investor confidence by providing for rule of law, public services capacity, and a national capability to attract FDI and compete for capital in international marketplaces.

There are a number of areas in which professional/technical advisors can contribute to the development of effective property assessment and taxation systems that support government policy and meet

market participants' needs within the broader LAS.

National Policy Development

Building property assessment capacity is greatly enhanced if there is a shared understanding of and commitment to the country's policy objectives, as they relate to property assessment and taxation. Straightforward as that may seem, a common understanding can be difficult to achieve if the responsible ministries (i.e., for land administration and for finance) have different agendas—as they often seem wont to do for a variety of reasons. Policy objectives may relate to revenue targets through property transfer and periodic taxation, land use and speculation control mechanisms, funding distribution for infrastructure development and public services delivered through local and central governments, and so on.

A critically important requirement is to maintain the degree of independence and objectivity in the assessment function necessary to build public confidence in the assessment system. Professional independence and objectivity are more difficult to achieve when the property assessment function is under control of the taxing or finance authorities.

Policy development and implementation reflect many dimensions, such as the present market maturity level as the country shifts toward formalized property markets, and the need for developing the market participants' cognitive capacity necessary to achieve public acceptance of new systems. Policy for ad valorem property assessment can recognize the need for administrative efficiency, effective tax yield (Bahl and Wallace 2010), and property market maturity. However, policy should also address the related questions of the potential decentralization of related property tax administration and the local administrative capacity to effectively implement the policy, especially when corruption may be an issue.

Legal Capacity and Legislative Framework: (Advancing the Rule of Law)

Many developing countries promote the rule of law as part of their development programs. (*Rule of law* is not a precisely defined term, and its meaning varies among nations and legal traditions. It is generally



taken to refer to protection of citizens' rights from arbitrary and abusive use of government power (University of Iowa Center for International Finance and Development, http://www.uiowa.edu/ifdebook/faq/Rule_of_Law.shtml). The important principles for a successful tax system, as provided for in national policy, need to be enshrined in legislation—principles that are necessary to administrative efficiency, system integrity, public acceptance, and trust. Cultures can vary considerably, but if basic property rights and taxation principles are not protected through the rule of law, policy objectives are not likely to be achieved, as might be seen in tax yields that are unsurprisingly low and taxpayers' creativity and ingenuity in avoiding taxes.

Institutional Framework (Governance)

Selecting and implementing the most appropriate governance model is important, not only to achieving efficient operations and effective service delivery but also to providing for fiduciary responsibility and transparency through public reporting. Clarifying roles, rights, and responsibilities helps avoid conflict among the key system proponents, who may include minister(s) responsible for land administration and finance, board or commission members, management, and local tax authorities. These parties may need guidance in establishing a framework in which the following questions are resolved:

- Who sets strategic direction?
- Who develops assessment (high-level) policy?
- Who monitors overall organizational performance?
- Who is responsible for executing strategy and setting valuation (operational) policy?
- Who sets and manages service delivery requirements?
- Who is responsible for results and performance management?
- What are the organization's performance reporting and public reporting requirements?

Professional Capacity

Opportunities for professional/technical growth and continual improvement

can be provided through international collaboration with leading practice organizations. Benefits may include assistance in the following:

- Access to education programs that can be adapted to the local environment
- Access to communities of practice, which provide sources of innovation and best practices that may be adopted and/or adapted to suit the developing country's context
- Specification of codes of conduct and development of professional practices that are respected in international property markets
- Adaptation of valuation standards and methodologies appropriate to country circumstances, culture, and property market maturity level.

Organizational and System Capacity

A full discussion of building organizational and assessment system capacity is beyond the scope of this article, but professional organizations and their members can provide advice on the following important areas of capacity development.

- *Organizational Design.* The following typical questions need to be considered in defining an appropriate organization design for operation and service delivery of the property assessment system:
 - What is the public purpose of the property assessment system (as set out in national policy and enabled through legislation)?
 - Should government assume a role in achieving the defined public purpose for the property assessment system? At what level of government?
 - To what degree should the private sector or service providers be involved?
 - What organizational designs and performance capacities best enable effective/efficient achievement of the property assessment system mandate?
 - What degree of objectivity and independence is required to build public confidence?

- How will oversight be accomplished?
- *Management and Leadership*
 - Defining the right leadership team at the outset is critical to success.
 - A management structure needs to be defined and implemented as early in system development as possible, to build capacity to develop and execute the strategic and operational plans. The management structure will likely change as the assessment organization passes through start-up into full operation, especially when the property assessment system is centralized and serves a large geographic area with multiple taxing jurisdictions.
- *People.* Early, continual professional and technical skills development is a critical component. Professional advice can help the developing country develop and execute its staffing strategy, so that sufficient and trained resources are in the right locations to execute the organization's initial project plan and deliver property assessment services to build public confidence.
- *Assessment Policies, Standards, and Procedures.* A key area for professional organizations to provide technical advice is the development of assessment and valuation policies, standards, and procedures related to all aspects of a mass appraisal system, including data and information management, sales and market analysis, valuation, performance analysis and quality assurance, public relations, and appeals administration.
- *CAMA/GIS.* A functional property assessment system relies upon a number of integrated technologies and information technology support, including a land information system (property database); geographical information systems, and a computer-assisted mass appraisal system—all focused on enabling the end user and delivering service to customers, including taxpayers and taxing authorities.

- Funding.** Selection of a funding model for the assessment function is critically important to meaningful fiduciary responsibility and the degree of independence necessary to sustaining public confidence in the assessment system. Both start-up (capital, operating, and development funding) and post-start-up funding options should be considered. The latter might include options such as direct taxpayer funding, national funding, local government funding, or, for related valuation services, private-sector profit centers.

There are significant challenges to building capacity in ad valorem property assessment in a developing country—valuation capacity that can support not only tax policy but also evolution to mature property markets—to fund local government and also to encourage wealth creation and economic growth but not at the expense of destabilizing land tenure, creating conflict or exacerbating local poverty. (*Valuation capacity* does not imply that the same values can be used for taxation as for other purposes. Rather, integrated databases and technologies, together with professional expertise, can deliver valuation services to meet multiple needs.) If they take time to learn the local culture, Western societies and their professional organizations have the expertise and experience to provide such guidance to help achieve those objectives. In turn, they can benefit from building collaborative relationships and expertise that are a necessary preface to their own success in responding to global property market trends.

Conclusion

Paradigm shifts are occurring in LAS world-wide, as those systems are adapted to respond to global trends and changing requirements of international market participants. Developing countries need to build capacity in their LAS, including property assessment systems. And professionals in developed countries need to grow their knowledge and awareness to help ensure that clients, at home and abroad, are better served and that property assessment services continue to be relevant in their changing environments. Creation and implementation of market-based assessment systems can contribute both to advancing

the country's LAS and to development of its property market maturity.

Assessors and their professional organizations gain by contributing to coherent land management policies and to continual improvement in integrated LAS. Developing reliable market-based assessment systems and building capacity to deliver valuation services throughout the evolutionary stages of international property markets are an integral part of that challenge.

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As assessors gain a broader understanding of global issues, they are introduced to collaborative opportunities that allow meaningful contributions to poverty reduction, economic growth, and wealth creation through more efficient and effective property markets.

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