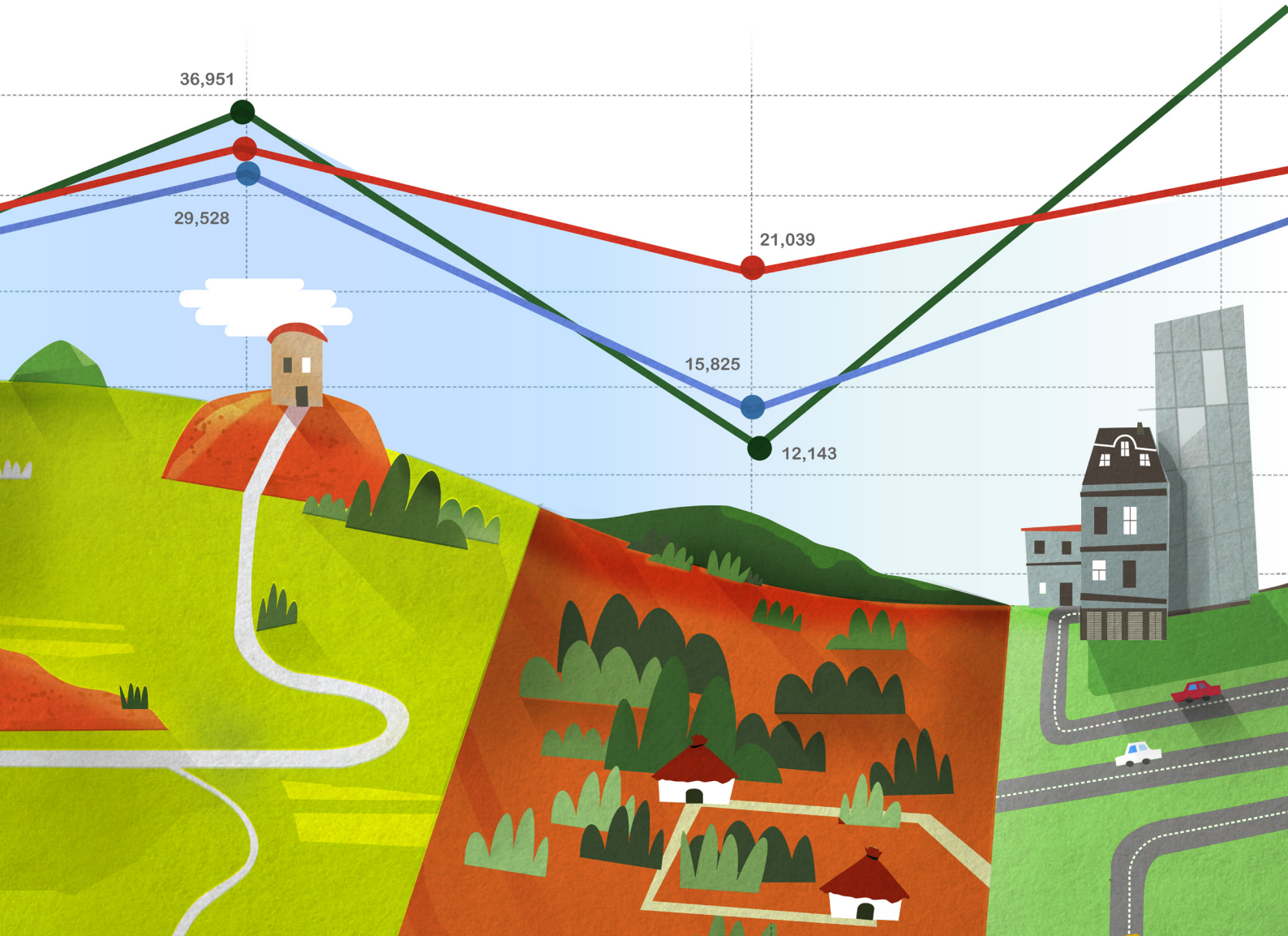
Food and Agriculture Organization of the United Nations

GOVERNANCE OF TENURE
TECHNICAL GUIDE
11

# Valuing land tenure rights

A technical guide on valuing land tenure rights in line with the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security



The FAO Governance of Tenure Technical Guides are part of FAO's initiative to help develop capacities to improve tenure governance and thereby assist countries in applying the *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*. The FAO Governance of Tenure Technical Guides are prepared by technical specialists and can be used by a range of actors. They:

- translate principles of the Guidelines into practical mechanisms, processes and actions;
- give examples of good practice – what has worked, where, why and how;
- provide useful tools for activities such as the design of policy and reform processes, for the design of investment projects and for guiding interventions.

For more information on the Guidelines and FAO's activities on governance of tenure visit: **www.fao.org/tenure**

# Valuing land tenure rights

A technical guide on valuing land tenure rights in line with the *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*

**FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS**
Rome, 2017

This publication is intended to support the use of the *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*. It is not intended to contradict the language of the Guidelines as endorsed by the Committee on World Food Security on 11 May 2012 nor the role of States in their implementation.

This publication has been developed with the financial assistance of the Food and Agriculture Organization of the United Nations (FAO), and the United Kingdom of Great Britain and Northern Ireland. The views expressed herein are those of the authors and do not necessarily reflect the official policies or views of FAO.



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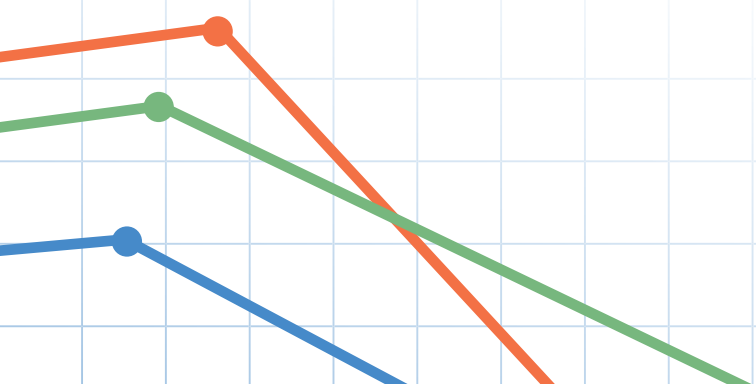
# Contents



# Acknowledgements

This technical guide was prepared by a team led by Peter Wyatt from the University of Reading in the United Kingdom and a team of fourteen valuation experts comprising Adarkwah Antwi, Land Tenure Expert/Real Estate Market Analyst from Ghana, Ben Elder from the Royal Institution of Chartered Surveyors in the United Kingdom, Christopher de Gruben from M.A.D. Investment Solutions in Mongolia, Eric Allen from the National Land Agency in Jamaica, Jan Brzeski from the International Property Tax Institute in Canada, Maxwell Mutema from the Zimbabwe Institution of Engineers (FZweIE), Mike McDermott from the Global Property Advisory in Australia, Néstor Garza and Dann Payares from the Universidad del Norte in Colombia, Nivedita Haran from the Government of Kerala in India, Phan Trung Hien from the Faculty of Law at Can Tho University in Viet Nam and William McCluskey from the School of the Built Environment at Ulster University in the United Kingdom and Andrew Hilton, Paul Munro-Faure and Mackay Rigava from the Food and Agriculture Organization of the United Nations (FAO). The guide was prepared under the direction of Paul Munro-Faure, Andrew Hilton, and David Palmer. It was edited by Christabel Clark and Luca Feliziani designed the layout.

A workshop, co-hosted by FAO and the University of Reading, provided an opportunity to conduct a detailed review of an earlier draft of this guide.

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# Abbreviations

| | |
|---|---|
| DCF | Discounted Cash Flow |
| DIP | Deliberative and Inclusionary Process |
| DRC | Depreciated Replacement Cost |
| ECA | Europe and Central Asia |
| FAO | Food and Agriculture Organization of the United Nations |
| HABU | Highest and Best Use |
| IAAO | International Association of Assessing Officers |
| IFC | International Finance Corporation |
| IFRS | International Financial Reporting Standards |
| IPMS | International Property Measurement Standards |
| IRPF | International Real Property Foundation |
| IVS | International Valuation Standards |
| IVSC | International Valuation Standards Council |
| JFM | Joint Forest Management |
| LADM | Land Administration Domain Model |
| LUC | Land Use Certificate |
| LUR | Land Use Right |
| MRA | Multiple Regression Analysis |
| NPV | Net Present Value |
| RICS | Royal Institution of Chartered Surveyors |
| SDR | Social Discount Rate |
| UN | United Nations |
| USAID | United States Agency for International Development |
| VGGT | Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security |

# Foreword

Value, whether defined in purely economic terms or more widely to encompass social and environmental value, is an important basis for making decisions about legitimate tenure rights. Valuation, the process of estimating value, forms part of the evolution and improvement of land, fisheries and forests, which can have an overarching influence on the general economic development and growth, wealth and prosperity of a community, society or nation.

Valuations of tenure rights are required by the State and by the private sector for a wide variety of reasons, often forming and informing the basis of transactions, taxation, compensation and accounting. Value and the valuation process form a part of our everyday lives, and yet these are often shrouded in mystery and are not clearly understood. Valuation is not merely hypothetical – a significant proportion of complaints and legal challenges in many countries are grounded on valuation, be it claims of inadequate levels of compensation for land taken by the State, or resistance to high land and property taxes, all of which have legal and financial consequences.

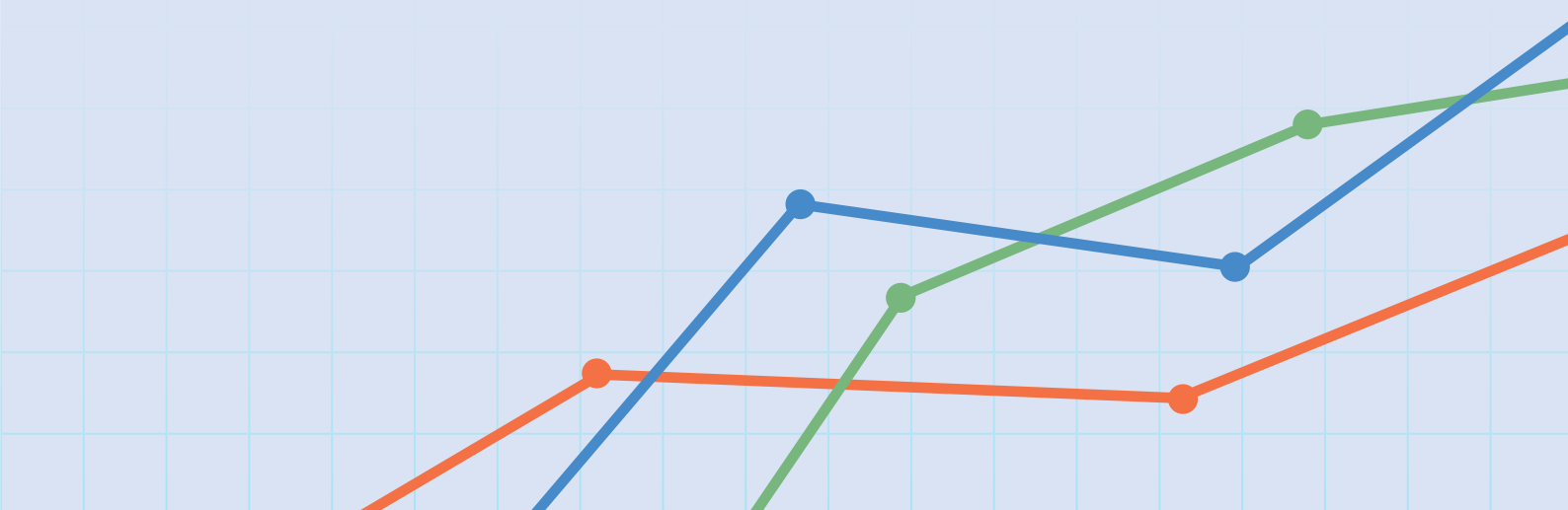
The *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security* (hereafter the Guidelines) endorsed in 2012, are the first international consensus on the centrality of tenure rights. They enforce the recognition and protection of tenure rights and the importance of tenure security to national food security. The Guidelines recognize the complexities of effective land administration associated with the delivery of tenure-related services and specifically reference the importance of valuation.

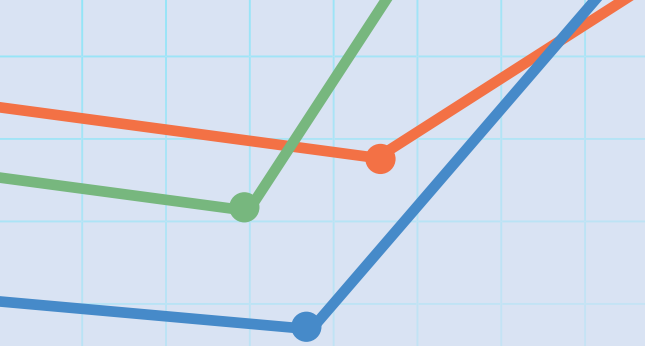
The Food and Agriculture Organization of the United Nations (FAO) has developed a series of Technical Guides to elaborate and provide more detailed guidance on thematic areas contained within the Guidelines. As part of this series, this Technical Guide covers the issues associated with the identification and valuation of tenure rights for different purposes, and provides guidance on how to ensure that valuations are undertaken in a fair, reliable and transparent manner that comply with international norms. It explains why valuations are important, where and when they should be used, and by whom. It is not intended to be a valuation textbook; instead it seeks to raise the level of awareness of valuation issues and procedures among those involved in land policy and administration and those affected by land tenure decisions.

Though this Technical Guide focuses on land, it provides useful guidance that may be applied to fisheries, forests and other natural resources. It is directed primarily towards developing countries and countries in transition where there is less awareness of the valuation profession and institutions. Legitimate tenure rights involving customary or informal tenure systems may be less clear and not formalized by law or regulations.

The other Technical Guides in the series also contain references to themes contained herein, and are thus complementary to this guide. Readers interested in specific aspects of the implementation of the Guidelines, such as gender, legal aspects, free, prior and informed consent (FPIC), agricultural investments, registration, the commons, pastoralism, forestry or fisheries, can also refer to these Technical Guides.

# 1
# Introduction





# 1. Introduction

## 1.1 Key points

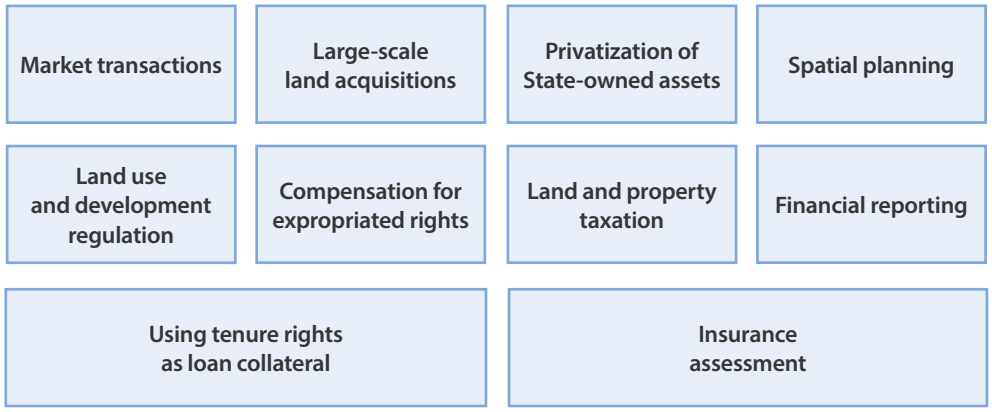
- Value arises from holding legitimate tenure rights to land, fisheries and forests. Value is widely adopted as a basis for making decisions about how these rights are allocated among individuals and communities.
- Section 18 of the Guidelines focuses on valuation. It recommends the development of systems for valuing tenure rights that, in addition to economic value, take account of social, cultural, religious, spiritual and environmental values. Transparency should be a key principle of these systems, not only to assist with the valuation process itself but also to help prevent corruption. Valuation capacity should be developed in the form of standards and training.
- Valuation – the process of estimating value – is supported by and forms an integral part of the evolution and growth of land and property markets, which can influence general economic development and the prosperity of a society.
- The degree to which valuations are needed depends on the size of trading markets in tenure rights, the volume of lending activity in those markets and the policy requirements for valuations to support government taxation, land restitution, land consolidation and expropriation activities.

## 1.2 Background

Value, whether defined in purely economic terms or more widely to encompass social and environmental value, is an important basis for making decisions about legitimate tenure rights. Valuation – the process of estimating value – forms part of the evolution and improvement of land, fisheries and forests, which can have an overarching influence on the general economic development and growth, wealth creation and prosperity of a community, society or nation.

Valuations are required by the State and by the private sector for a wide variety of reasons.

ACTIVITIES THAT TRIGGER VALUATIONS




The Guidelines refer to market value and non-market value. These concepts are attempts to express the worth of the environmental, social and economic rights that are important to a broad variety of stakeholders. To date, valuation practice has focused on the estimation of market value or value-in-exchange. Later in this Guide, Chapter 4 shows that market value has a formal basis grounded in the analysis of market transactions. Active and transparent markets are able to facilitate more reliable valuations whereas valuations in emerging markets, where information is difficult to obtain, are more uncertain.

Estimating the non-market value of tenure rights in land, fisheries and forests is a more challenging, but nevertheless, vital undertaking since it attempts to quantify the non-economic benefits that land and property offer. Not all of the advantages of holding tenure rights are priced in markets: social connections, an identity, subsistence farming in times of need, a connection with the environment and the stewardship that it engenders. Markets struggle to price these qualities so the concept of non-market value is a first step towards recognizing, identifying and accounting for them.

## 1.3 Why value tenure rights?

Below are examples of reasons why valuations are required by individuals, businesses, communities and governments. Chapter 3 will present a more detailed discussion together with case studies and guidance.

### Transferring tenure rights

Tenure rights may be traded in order to relocate or expand a residence or place of business. Land and property may be bequeathed to children. Owners of tenure rights may wish to lease farmland, fisheries or forestland to others. Valuations provide the necessary information to allow parties to negotiate an agreeable price or rent. Alternatively, holders of tenure rights may identify opportunities to develop or

redevelop their land or use it for another purpose. Valuations help determine what land is worth in its current use as a farm or forest for example and whether it might have a higher value if it can be redeveloped for, say, housing or commercial use.

In some countries the State owns a lot of land and, in order to put it to good use, the State may decide to sell or lease it to farmers, forest enterprises and so on. Valuers can advise on the best means of disposal, how much the land should be sold for and the terms of any lease that may be agreed.

There is a growing movement, particularly in Africa, for large-scale investors to acquire substantial tracts of land for agricultural use or commercial development. Valuations help ensure owners and occupiers receive fair market value for their tenure rights. This can be very important in cases where the tenure rights are customary or informal.

The Guidelines recommend that States recognize and facilitate markets as a means of transferring tenure rights in land, fisheries and forests (Section 11.1). Once legitimate tenure rights are recognized, markets can develop to enable the buying, selling and leasing of these rights.

## Regulated spatial planning and expropriation of tenure rights

Regulation of land use is essential. Some activities need to be located apart from others and some land uses are better located near each other. Infrastructure (roads, railways, schools, hospitals) needs to be planned to provide effective services to rural, commercial and residential communities.

Planning policy and decision-making can have a substantial impact on value. Valuations help inform decisions about the best way to lay out a road network in a new urban extension. It helps in defining whether some of the cost could be recovered via a land tax, or what might happen to land values if a new rapid transit system is constructed and how much tax revenue it might generate.

A key motivation for developing an objective and impartial valuation capacity is to ensure that when legitimate tenure rights are expropriated, fair compensation is awarded to affected parties. Consider, for example, a country that is in the process of upgrading its public transport infrastructure and wishes to acquire land for a new railway line. How much should the acquiring authority pay for the land required to construct the railway? How do landowners know whether their land is being acquired at a fair price? Valuations answer these vital questions.

## Land and property taxation

Many countries regard land and property as a legitimate source of tax revenue, particularly for local government expenditure such as medical, police and fire services, and maintenance of infrastructure and amenities. Land and property value is widely used as a means of allocating tax liability fairly among owners and occupiers of rural and urban tenure rights. Regular revaluations can be undertaken to ensure fairness is maintained as values change over time and public access to these tax valuations means that taxpayers can appeal against their payment liability if they wish to.

*“ The fair valuation of legitimate tenure rights is now widely recognized as a global concern. For example, the New Urban Agenda (UN Conference on Housing and Sustainable Urban Development, 2016) encourages countries to capture and distribute any uplift in land value that results from public investment, and also offers support for the development of land information records (including records of legitimate customary rights as well as sales and lease records) to assist valuation.*

### Accounting, lending and insurance

Businesses should be aware of the current value of their land and property assets. If company assets are undervalued, the business could be acquired cheaply, closed down and the assets sold at their break-up value. This ‘asset stripping’ is damaging to an economy. Regular valuations of land and property help prevent this kind of activity.

If legitimate tenure rights can be used as security for loans, the value of those rights is a key factor in deciding whether and how much to lend. For example, a farmer plans to invest capital to irrigate, fence and level some land and wishes to borrow money from a bank using the land as collateral for the loan. The bank needs to know whether the land is worth more than the amount of the loan and the farmer should know whether the money invested will add more value than the cost of the loan.

Finally, land and property are valuable assets but they are real, physical entities too and therefore vulnerable to all sorts of risks such as flooding, fire, earthquakes, subsidence, contamination or invasion. It is important to mitigate these risks and insure against them. Insurers undertake risk assessments and valuations to check that their premiums and level of cover are appropriate.

## 1.4 The Voluntary Guidelines and this Technical Guide

*“ The Guidelines promote responsible governance of tenure of land, fisheries and forests, with respect to all forms of tenure, to achieve food security for all. By endorsing responsible governance and setting out principles and standards to assist stakeholders when establishing land tenure policy, the Guidelines contribute to achieving sustainable livelihoods, social stability, housing security, rural development, environmental protection, and sustainable social and economic development.*

By examining the conduct of societies we can see that value is widely adopted as a basis for making decisions about how legitimate tenure rights are allocated among individuals and communities. Globally, and particularly in developing countries, there is a pressing need to understand how the value of tenure rights arises and can be estimated, particularly in situations where there are vulnerable populations and where there is unequal access to information, knowledge and power. This is recognized in the Guidelines, which call for appropriate valuation capacities and standards to be available and applied as a better way to contribute to responsible governance of tenure.

The general principles of the Guidelines are to recognize, respect and safeguard legitimate tenure rights to enable their peaceful enjoyment, and provide justice if these rights are compromised. These principles are fundamental to the establishment of effective valuation systems because value stems from holding secure, beneficial interests in land and property. This might be market value capable of being traded or it might be non-market cultural or spiritual value.

Section 18 of the Guidelines recommends that:

- States ensure appropriate systems are used for the fair and timely valuation of tenure rights and that these systems promote social, economic, environmental and sustainable development objectives.
- As well as economic value, valuation systems take into account social, cultural, religious, spiritual and environmental values where applicable.
- Valuation standards are developed that are consistent with international standards and that are publicized so valuers and other stakeholders are aware of them.
- Valuations of tenure rights and valuation information and methods are transparent, publicized and accessible.

The concepts of value and valuation, from a market and a non-market perspective, in line with Section 18 of the Guidelines are introduced in this Technical Guide. It then explains why the valuation of tenure rights is so important and describes what a valuation is and how it is produced. Finally, it considers the essential components of a successful valuation system.

This Technical Guide is relevant to land policy and administration professionals, either directly involved with or potentially working in areas that require the valuation of tenure rights. It is equally important to holders of legitimate tenure rights and their representatives, including agents, consultants, professional advisors and civil society organizations.

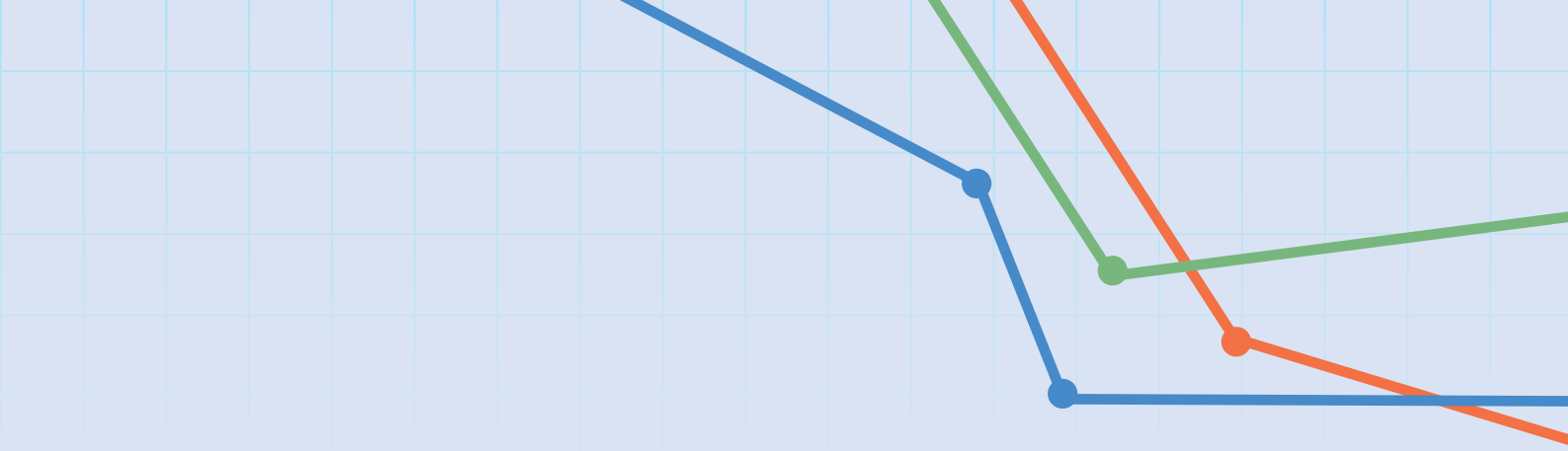
While this Technical Guide focuses on land, it provides useful guidance that may be applied to fisheries, forests and other natural resources.

## 1.5 Summary

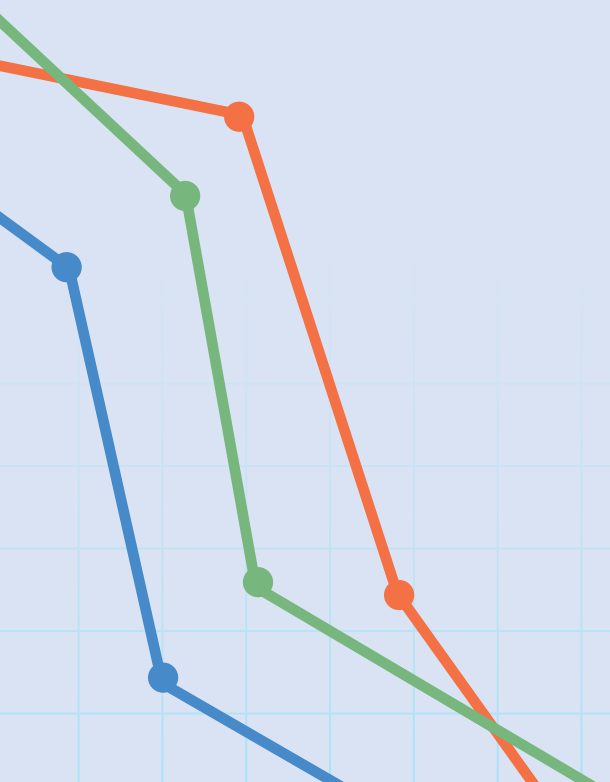
In accordance with Section 3 of the Guidelines, state and non-state actors should recognize and respect all legitimate tenure right holders and their rights, and:

- take reasonable measures to identify, record and respect legitimate tenure right holders and their rights;
- recognize the equality of individuals in terms of gender, age and vulnerability within the national context;
- engage with and seek the support of those with legitimate tenure rights who could be affected by decisions, prior to decisions being taken, and respond to their contributions, taking into consideration power imbalances and ensuring active, free, effective, meaningful and informed participation in decision-making processes.

- In so doing, states should follow the recommendations in Section 18 of the Guidelines in relation to the valuation of legitimate tenure rights and valuation systems, related policies and laws.
- Section 6 of the Guidelines recognizes that the efficient and fair delivery of services related to tenure (which includes recording and valuation services) depends upon adequate human, physical, financial capacity to implement laws and policies. It guides states to encourage relevant professional associations to develop, publicize and monitor high standards of ethical behaviour.



# 2
# What gives tenure rights “value”?



# 2. What gives tenure rights "value"?

## 2.1 Key points

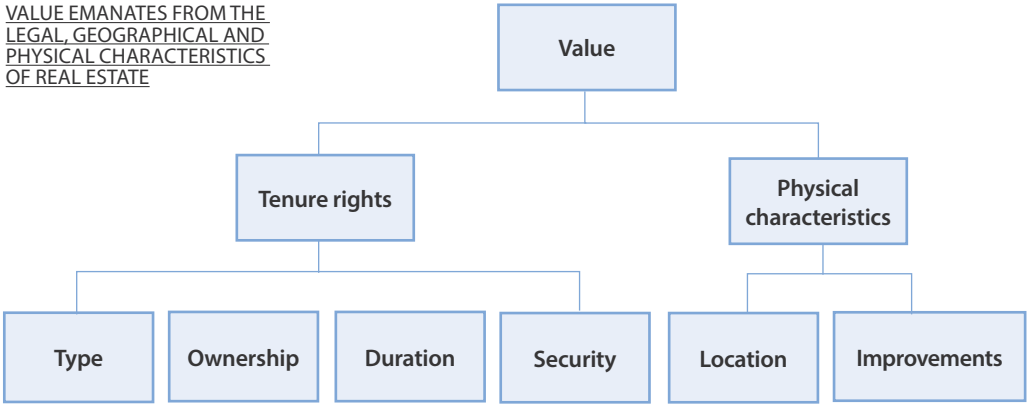
- Societies value those things that are important to them. Tenure rights are fundamental to society and are highly valued.
- Tenure rights permit the use, transfer and control of property rights over land. The nature and extent of these rights, and the location and physical characteristics of the land and property to which they relate, influence value. Valuation is the process of identifying and quantifying the effect these attributes might have on the value of tenure rights.
- There is no "one-size-fits-all" concept of value. Depending on the purpose of the valuation, economic conditions over time, individual or business perceptions of value and assumptions made by valuers, tenure rights can have more than one value.
- The influence of tenure rights, location and improvements on value should be placed within a wider market, economic, social and environmental context. This context is part of the cognitive background that valuers bring to a valuation, including market knowledge and an awareness of the current legislative framework, environmental policies and economic activity.
- The diversity of tenure and land use arrangements means that valuations can be complicated. This underlines the need for knowledgeable, skilled and experienced valuers and explains why standards are essential (see Chapter 5).

## 2.2 Background

The Guidelines promote responsible governance of tenure of land, fisheries and forests. Law is acknowledged as an important vehicle for translating the recommendations in the Guidelines into actions and a technical guide, *Responsible governance of tenure and the law,* was published by FAO in 2016. Central to this is recognition of the legitimacy of tenure rights, whether formal, informal, individual, communal, customary, permanent or transitory. Valuation has a key role to play in determining the value of these tenure rights in a wide variety of contexts, which will be discussed in Chapter 3.

Value emanates from attributes associated with tenure rights and the underlying land and property to which those rights relate. These two factors are discussed further in the following sections (2.3 and 2.4).

VALUE EMANATES FROM THE LEGAL, GEOGRAPHICAL AND PHYSICAL CHARACTERISTICS OF REAL ESTATE




Value is context specific; one size does not fit all. For example, value might refer to the rent that a tenant farmer pays to a landowner – a rental value. Or it may be an estimate of the price paid for the farm if it was sold – a capital value. There are also also different types of value depending on the purpose of the valuation.

**Value is contextual**

Valuations for taxation purposes may be based on certain, statutorily defined factors such as soil quality, agricultural productivity or the floor area of buildings. This can mean that tax values are different – often lower – than market values. If these tax values are used as a basis for estimating the sale price of state land, the government will not obtain best value, and if landowners are compensated for expropriated land on the basis of these land values, they do not receive fair compensation.

So tax valuations are not the same as market valuations – a great deal depends on the assumptions that are made during the course of a valuation, and these will be discussed in Chapter 4.

## Market value and non-market value

*“ Policies and laws related to valuation should strive to ensure that valuation systems take into account non-market values, such as social, cultural, religious, spiritual and environmental values where applicable (The Guidelines: Section 18.2).*

There are two concepts of value defined in the Guidelines, market value and non-market value. An economy is embedded within a wider societal and environmental context and this frames the way in which markets and values are formed. Market value is value-in-exchange and mainly influenced by the economic benefits that the tenure rights are capable of generating. Market values (or prices) are revealed when tenure rights are exchanged. Non-market value reflects non-economic qualities including social, cultural and environmental benefits that the tenure rights confer. An example of non-market value might be value that is ascribed to a community’s ancestral land.

Land and property that embody a cultural, historic or architectural heritage may have legal or statutory protection and their use may be restricted. They may be expensive to maintain and be less flexible to use. Indeed, it may not be possible to place a market value on them at all – an ancient monument or ruins for example – but cultural and historical value may be very high.

Non-market values are not revealed in markets so they are difficult to quantify. It is usually done during expropriation of tenure rights when non-market value needs to be estimated as a basis for compensation.

Non-market value is also a consideration when it comes to the strategic management of state land and property such as national forests and coastal areas. For example, if an investor wishes to acquire mineral extraction rights, as well as the loss of non-market value to the local community, there may be a wider cost to society as a whole. A forest provides timber and other forest products but perhaps offers social (amenity) value to the region and global environmental value. These wider non-market values are difficult to estimate but that does not mean they should be ignored. Governments may decide to set policies or introduce laws (e.g. tax, regulations, etc.) as ways of dealing with these costs to society and the environment.

**Implementing improved tenure governance in fisheries** (FAO, 2013a)

The relationship between market and non-market value is evident in the valuation of fisheries. The market value of a fishery would be estimated by assessing the current and future value of landed fish, less the costs for bringing them ashore. Even if a fishery is not currently being exploited it has a value associated with the option to exploit it in the future.

Non-market value might comprise:

Social value: This value may vary depending on the local importance of fishing and the existence of alternative livelihood opportunities. Small-scale fisheries often fill critical labour absorption and safety-net functions, and easy access to fishing can be important for poor households to sustain their livelihoods. Social value may also take the form of leisure fishing.

For many small-scale fishers and fish-workers, fisheries represent a way of life and this has an important cultural value, including value associated with the knowledge that future generations will have the opportunity to enjoy something. In some cultures, the value of a species or a specific area is related to the ancestral and spiritual practice of a community.

Fishery resources are part of ecosystems and have value as they provide ecosystem services. Ecosystem values are measures of how important ecosystem services are to people, including both coastal communities and other members of society at large. Services might include maintaining water quality or reef protection.

It is important to understand the different elements of the value of tenure rights and how the related benefits (and costs) are distributed – who gains and who loses – when allocating or transferring rights. A good understanding of value is also needed to inform policy decisions in the fisheries sector.

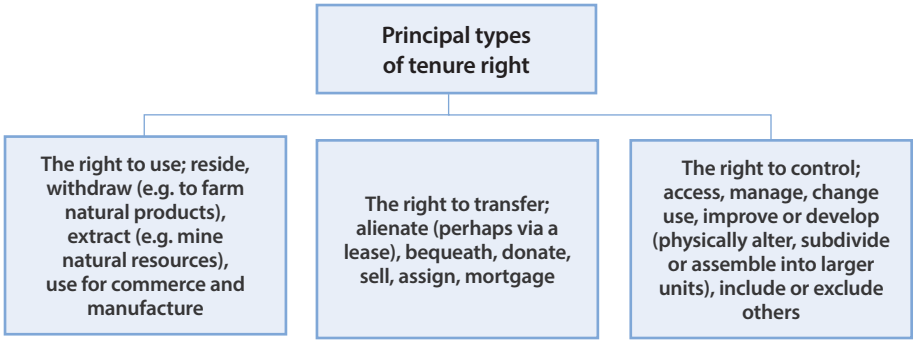
## 2.3 Tenure rights

*"How people, communities and others gain access to land, fisheries and forests is defined and regulated by societies through systems of tenure. These tenure systems determine who can use which resources, for how long, and under what conditions. The systems may be based on written policies and laws, as well as on unwritten customs and practices. (The Guidelines: Preface)*

When people talk about "land values", or "property values" they are really talking about the value of the "interest" in or "tenure rights" to the property. Tenure rights determine the degree to which people can legitimately enjoy or utilize real estate and other natural resources. Rights that are more comprehensive, exclusive, longer and more secure are the most valuable. Unencumbered ownership of perpetual tenure rights will be more valuable than a short terminable right to occupy the same land and property.

### Types of tenure rights

There are three principal *types* of tenure rights.



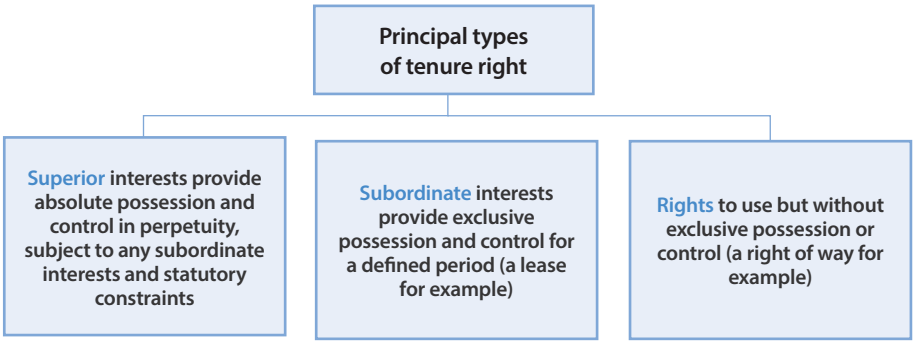

TYPES OF TENURE RIGHTS

Generally speaking, the more rights held, the more valuable the interest. There may be circumstances where specific tenure rights are not held. For example, landholders with informal tenure may not have the right to sell or lease their rights. This might be because the state retains ownership or it might be to prevent an imbalance of negotiating power with external actors (i.e. elites, corporations) in an attempt to reduce the risk of the landholders being misrepresented, manipulated or coerced into relinquishing their rights.

The prevention of transfer of tenure rights may also help maintain a community's collective identity, particularly in cases where territories of indigenous peoples are based on a communal tenure system. Some jurisdictions may grant alienation rights but with conditions. For example, in Papua New Guinea the law prevents customary landowners from leasing land directly to outsiders, so they have to first lease it to the State, which can then be subleased.

## Holding of tenure rights

The way that tenure rights are held or owned can significantly affect value. There are three principal levels of holding tenure rights:




LEVELS OF TENURE RIGHTS

As far as possible from the evidence available, valuers should apportion value among holders who enjoy different "levels" of rights to the same property. Identifying the holders of these various tenure rights can be challenging, particularly if the property is vacant or the occupiers are uncooperative. Additional resources may be required to collect and verify information in such circumstances. Tenure registration systems should record all levels of those holding tenure rights.

When considering ownership of tenure rights, two important considerations are gender and exclusivity. Regarding gender the technical guide, *Governing land for women and men* (FAO 2013b), provides a checklist for gender-equitable valuation.

**Governing land for women and men**

Ensure that valuation systems take into account non-market values.

Assess the influence of social factors – social relations, prestige, fraternity – on negotiations to establish the value of property, especially for vulnerable groups such as widows and women heads of household who have weak political bargaining power.

Keep fees to a minimum.

Explain to landowners how valuations are decided, especially to those women who have lower literacy levels and lack information.

Prevent corruption by making valuation information and analyses available to the public

**Gender equality**

In India legislation enacted in 2006 provides for the grant of rights to families living in forests. In the State of Kerala, the right is recorded in the joint name of the wife and the husband.

Regarding exclusivity, tenure rights may be held jointly, where parties share the whole interest, or severally, where each party holds a defined portion of the whole interest. If tenure rights are shared, then a valuer should apportion value to each tenure rights holder.

Tenure rights may be allocated to a specific community, which can exclude others from the land (Nzioki *et al.*, 2013). The community collectively determines how the land is used; each occupier of communal land may enjoy valuable use rights but cannot sell or otherwise transfer ownership of the land. A disadvantage of this approach is that occupiers may not be able to mortgage the land and this can deter investment.

Depending on a country's constitution, the land to which tenure rights relate may be privately owned or may be owned by the state on behalf of its people. In countries where the state retains ownership, individuals and organizations may be allocated land "use" rights, whereby the state owns the land and citizens own improvements to the land. These land use rights may be "sold" by the state on an indefinite basis for a fee or leased for fixed periods of time at an annual rent. Split tenure rights such as these have two important value consequences:

(a) Valuers may be required to separate the value of the land from the value of the improvements, even though they may be functionally linked and difficult to distinguish. For example, a farmer may have invested labour and capital to irrigate land, construct sluices and pumping stations. If the land is to be expropriated, compensation may be payable for the sluices and pumps but not for the irrigation channels.

(b) Valuers should consider the "market value" of the original location when estimating compensation to holders of land use rights. This can be difficult in a planned economy where free market trading of land is constrained; there would be little evidence of the market value of the original land.

In rural areas tenure rights may be held by the state, particularly in national parks and other protected areas. Forest land may also be state-owned, although it can be beneficial to jointly manage such natural resources with local communities.

**Joint Forest Management**

India runs a programme of Joint Forest Management, which splits tenure rights between the state and local communities. Forest communities can *hold access, use, manage and exclude rights,* but not transfer rights. The approach encourages sharing of products, responsibilities, control and decision-making between government forest departments and local user groups, based on a formal agreement. The main purpose is to give users a stake in forest benefits and a role in planning and management. At the same time the programme ensures that "outsiders" are prevented from purchasing and taking over forestland.

## Duration of tenure rights

Superior interests provide absolute possession and control in perpetuity. Subordinate interests provide possession and control for a defined period, via a lease for example, with the rent reflecting the value that can be derived from the land. It follows that superior (perpetual) tenure rights are often more valuable than subordinate rights, and long-term subordinate interests are often more valuable than short ones.

A particular element of value emanates from land and property that is subject to superior and subordinate tenure rights, known as reversionary value. This is value that will be realizable once a lease ends, the tenant vacates and the superior interest holder takes full possession of the land and property. Sometimes this reversionary value can be very high, particularly if tenants have made improvements to the land, increasing its value. There can be a strong incentive, therefore, for owners to terminate leases at the earliest opportunity. Valuers should check whether the law allows tenants to continue in occupation beyond the end of the original lease, as this will have a significant impact on the value of their tenure rights. Leases should be clear about what happens to the value of any improvements at the end of a lease.

Sometimes a low rent may be agreed alongside the payment of a lump sum or premium at the start of a lease. Similarly, a rent-free period at the start of a lease might be offered as an incentive to the tenant. The rent could be based (at least partly) on turnover, thus allowing the owner an element of profit share. Valuers should check for payments (monetary and in-kind) that are in lieu of price or rent. Whatever the form of payment, rent should be regularly reviewed to market levels to ensure that the market operates transparently and therefore efficiently.

There are two principal types of lease. Long ground leases are typically for periods of 50 years or more. An owner grants a lease of, say, a vacant parcel of land to an occupier who, in turn, may improve it and enjoy the benefits of doing so during the term of the ground lease. Historically, these ground leases required a rent to be paid that typically remained the same during the entire term. As time passed, the real value of this rent diminished. Nowadays, it is common to find rent reviews or some other arrangement written into ground leases that enable owners to participate in rental value growth.

Shorter occupation leases are usually granted in respect of buildings and other improved land. Occupiers may be able to subdivide and sublet but only for durations of less than the length of any head lease. During the lease the rent may be periodically reviewed. Depending on the legislative context, at the end of a lease term an occupier may have a right to renew the lease

## Security of tenure rights

*"States should, in drafting tenure policies and laws, take into account the social, cultural, spiritual, economic and environmental values of land, fisheries and forests held under tenure systems of indigenous peoples and other communities with customary tenure systems (The Guidelines: Section 9.7).*

There is a spectrum of security ranging from legally registered titles of demarcated land parcels, to customary tenure and informal occupation. The latter consists of little more than de facto recognition of occupation via political patronage, receipt of utility bills or payment of property taxes. The degree to which tenure rights are formalized has a significant impact on value because occupiers, investors and lenders regard registered title as less risky.

**Conclusive Titles**

In India the Registration Act, 1908 provides for the registration of deeds and documents and the title conferred is "a presumptive title". In 2008 the Conclusive Land Title Act was passed which declared that the land titling system in India would be converted into a "conclusive title" system. In doing so all land records are to be recorded in a secure geo-referenced database, and every land title is guaranteed. This is a major improvement on the previous land records system, and will help to avoid protracted civil suits and attract more investment.

In many countries, rural land is held under customary rights. Often involving social transitions of entitlement in unregulated markets, land held under this form of tenure is passed from generation to generation via family lineages and inheritance overseen by traditional leaders. Typically, formal land markets do not exist and ownership details and transaction information can be difficult to obtain.

Customary and informal tenure rights are often the most valuable assets possessed by rural communities, forming the base for subsistence and cash crop agriculture. These rights may be created through informal or oral agreements or arise from the customs and practices of local communities and relate to individuals, households and extended families. It is these household or extended family level rights and agreements that often drive economic use of land for both subsistence and cash crop agricultural production.

Valuing customary and informal tenure rights is challenging; identifying the specific nature of the rights (use, transfer, control etc.), the owners of those rights, and the wider political context. The price that someone pays for informal tenure rights might, for example, reflect the prospect of formalizing them sometime in the future. Unregistered land may be transacted informally and undocumented, and prices are often low due to the risk of conflicting claims on possession and occupation. A valuer may be confronted with multiple oral customary interests that create rights ranging from perpetual interests to time-limited interests, and other forms of agreement that may be determined on the occurrence of certain events.

It can be difficult to identify the true extent of interests to be valued. It is important to ensure that legal constructs of customary rights accord with observed rights. For example, constitutional provisions may restrict customary land grants to leasehold rather than transfers in perpetuity. However, if informal or oral grants of crop and farm share agreements strongly resemble perpetual interests, should the interest be valued as encountered or as constrained by the constitutional provision? This is based on a hypothetical leasehold interest, which implies setting, arbitrarily, commencement and termination dates, rent and other terms.

Valuations can be particularly challenging where ownership and occupation is split between many holders. Tenure rights need to be defined precisely so that buyers and sellers know what they can and cannot do with land and property. For example, a household or extended family that holds customary rights over forestland may enter into a farming operation agreement with a non-community member who clears the forest and cultivates a cash crop. Depending on custom, the third party may

**Valuing customary tenure rights**

In Liberia, customary rights constitute the principal mode of land holding in rural areas. These rights are to be formally recognized as communal holdings, thus removing large areas of rural land from direct control of the State. The proposed Liberia Land Rights Act will create customary residential land "entitlements" for community members to enable them "to hold and keep his or her customary land residential area perpetually in the same way as private land is held." The land is "alienable, descendible, divisible, and can be pledged or used as collateral/ security for the member's obligations to any person". This creates an identifiable interest in residential land for valuation purposes. For agricultural land "every member of a community shall be entitled to carry on agricultural activities on as much of the customary land appropriate for and dedicated to agriculture, and which in fact is accepted and used for farming and other agricultural activities". Because there is no mention of alienability, pledging or collateral for obligations, such land is more challenging to value. For example, what tenure rights does farming continuously on community land create for an individual, a household or an extended family? Can a household exchange or lease such farmland? What is the status of farmland that a household or extended family leaves fallow but wishes to farm in the future, as is commonly practised? Rural communities have customary practices to deal with such questions and a valuer would need to investigate these.

gain perpetual or terminable rights. A valuer would need to identify which interests are perpetual, which are terminable, and disentangle them to identify and value each one. Another difficulty stems from the absence of market data. Transactions, apart from being undocumented, tend to be complex, involving crop or land-sharing agreements.

Notwithstanding the valuation challenges posed by customary and informal tenure rights, independent and objective valuations of these rights have the potential to improve the welfare of rural inhabitants by:

- helping to eradicate fraudulent and corrupt rent-seeking practices;
- revealing prices of customary tenure rights, thus triggering exchanges that could optimize investment of capital and labour, moving families from subsistence to cash crop agriculture and other welfare-enhancing uses of land;
- providing fair compensation for expropriation of customary tenure rights;
- supporting government land administration practices, including land taxation and state-land leasing or sales.

Therefore, valuers need to understand customary and informal markets. Important questions include:

- Can the tenure rights be categorized? For example, how many layers of interests exist between occupier and landowner? Are there any use rights, such as migratory pastoralists, periodically using land?
- Is there any evidence, such as written or observed verbal agreements, to corroborate identified tenure rights?
- Where does finance come from? Purchasers of informal rights may be unable to borrow money to help finance their acquisitions and so sellers sometimes accept instalment payments. If money is borrowed, the arrangements can be risky for both borrower and lender and therefore the cost of the loan (the interest rate) can be high.
- Is there an accessible legal system to resolve disputes? Is there a functioning insurance system? These may not be recognizable in the formal style of developed markets but they often exist informally.
- Can informal rights be compared with similar rights held on a formal basis and establish benchmarks for returns and benefits?

## 2.4 Physical characteristics

The value of land will vary depending on where it is, and the value of improvements to land will vary depending on their nature and extent.

### Land

Accessibility is a key influence on value, the importance of which is dependent upon how the land is used. It is important to consider the location of land use activities in relation to travel infrastructure and neighbouring uses. The various needs for access result in a process of competitive bidding between different land uses. A price pattern emerges that is correlated with the pattern of accessibility. Farmland or forestland that is more accessible to markets for produce and livestock is likely to be more valuable than farmland further away.

Other important location considerations are the benefits that can accrue when similar land uses cluster together. Once land in an area has been assigned to a particular use, this will largely determine the best use for adjacent land due to advantages of clustering. The extent of the benefit depends on the need for contacts. Shops tend to group together. Offices cluster near shopping facilities and desirable residential neighbourhoods. Industry benefits from grouping production sequences. Smaller firms tend to group together but larger firms are less dependent on clustering because they are able to internalize their production processes. Some land uses, heavy industry and residential dwellings for example, prefer to locate apart to minimize social costs.

### Improvements

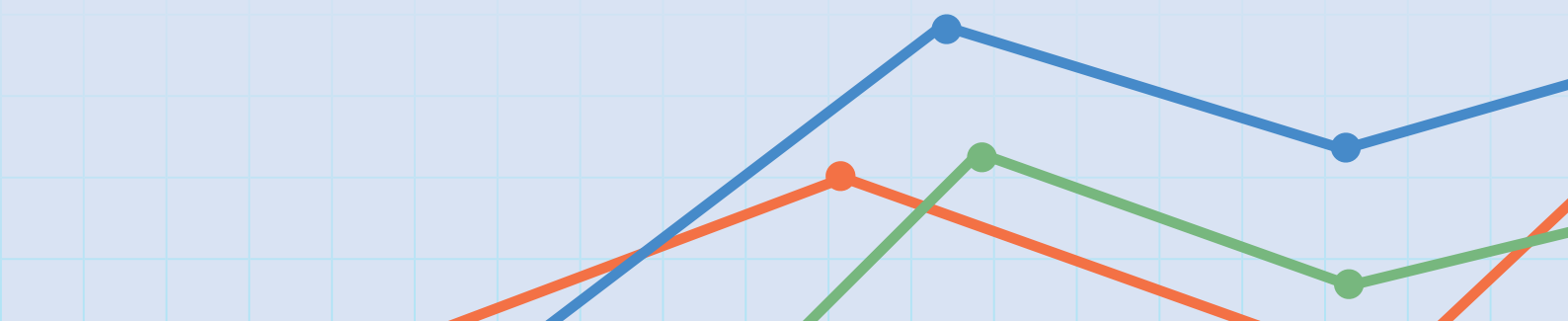
The nature of, and the extent to which improvements influence value will vary, depending on how the land is used. Each land use is often valued separately. A high level classification of uses might be: agriculture and fisheries, forest, minerals, recreation and leisure, transport, utilities and infrastructure, residential, community services, retail, industry and business, defence, vacant, derelict and unused land. Below this there are likely to be many categories and subcategories, the detail of which will be largely dependent upon the value differentials between uses. A land information system (see Section 5.2) can be a valuable tool for recording current land use.

Value will also be influenced by the degree to which any improvements can be adapted to other uses, in other words, their flexibility for change of use. It is important to consider potential alternative uses, as these may be more valuable than the current use.

## 2.5 Summary

- ✓ States should recognize the importance of the valuation of all tenure rights – formal, customary and informal – and valuers should recognize that the degree to which tenure rights are formalized could have a significant impact on value.
- ✓ Estimating the market and non-market value of tenure rights is difficult when they are not clearly defined; when markets are not well developed; and when valuation professionals and standards are absent.
- ✓ Valuers should be able to value different types of tenure rights and be able to separate the value of land from the value of improvements.
- ✓ Valuers should be able to apportion value among holders who share tenure rights or enjoy different "levels" of rights in the same property.
- ✓ Customary and informal tenure rights present unique valuation challenges. Valuers need to understand customary and informal markets and, in particular, appreciate the distinction between the market value and non-market value of such tenure rights.
- ✓ When valuing all tenure rights, valuers should consider the location, improvements and potential alternative uses, and ascertain whether the current land use is legally permitted, as this will affect value.

# 3
# Why value tenure rights?



# 3. Why value tenure rights?

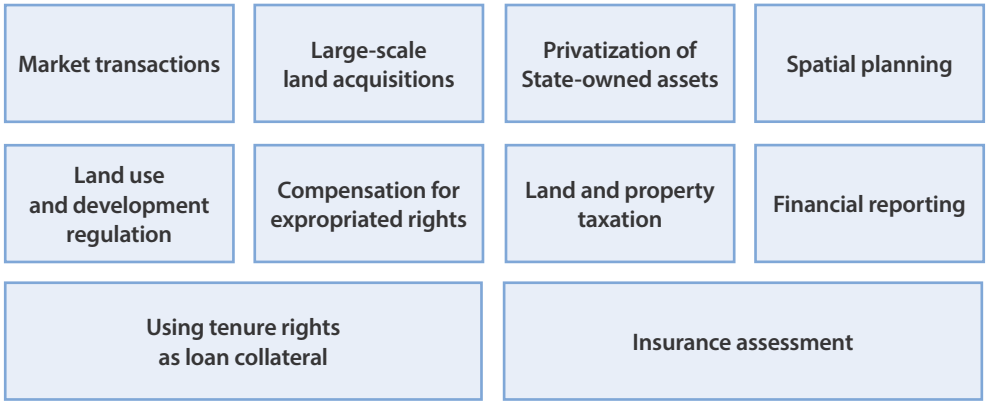
## 3.1 Key points

- Whether defined in purely financial terms or more widely to encompass social, amenity and environmental qualities, value is a fundamental basis on which decisions in relation to tenure rights are made.
- Valuations support the trading of tenure rights; they provide liquidity to sales and lettings markets by supplementing price information with valuations. This is particularly important when transactions are infrequent or when market information is inaccessible, unreliable or unverifiable.There is no "one-size-fits-all" concept of value. Depending on the purpose of the valuation, economic conditions over time, individual or business perceptions of value and assumptions made by valuers, tenure rights can have more than one value.
- Valuations are key to decisions about whether to invest in or develop land. They also support lending decisions, insurance risk assessment and the reporting of fair value of land and property assets in financial accounts.The diversity of tenure and land use arrangements means that valuations can be complicated. This underlines the need for knowledgeable, skilled and experienced valuers and explains why standards are essential (see Chapter 5).
- The State has specific requirements for valuations. In relation to taxation, it may be necessary to value large numbers of land and property holdings on a regular basis. Regarding expropriation of tenure rights, assessments of market and non-market value will be required on an individual basis.

## 3.2 Background

This chapter explains the main reasons for valuing tenure rights. Building on Section 1.2 in Chapter 1, it provides the context for valuations in each of the key areas of valuation practice. Each of the sections begins with a scenario that sets out an example requiring valuation. The valuation issues are then explained and guidance provided.

REASONS FOR VALUING TENURE RIGHTS




## 3.3 Transactions in legitimate tenure rights

SCENARIO: A state owns a large area of rural land and wishes to agree leases with tenants who will only be permitted to farm the land; they will not be allowed to sell or otherwise transfer their leases to anyone else. The state is also looking to sell tracts of rural land to large agricultural companies. The sale terms will be more flexible than the lease agreements and will allow companies to use the land in a variety of ways, as well as subdivide and sell individual lots. There have not been any transactions involving similar land before so the state does not know what a fair or market price might be. The state is aware that local farmers feel aggrieved because large companies are outbidding them for the best agricultural land. They feel that this is due to the more favourable transaction arrangements that companies are receiving and their ability to commission expert advice on matters related to value.

“ *Where appropriate, states should recognize and facilitate fair and transparent sale and lease markets as a means of transfer of rights of use and ownership of land, fisheries and forests (The Guildelines: Section 11.1).*

“ *States should establish policies, laws and regulatory systems and agencies to ensure transparent and efficient market operations, to provide non-discriminatory access, and to prevent uncompetitive practices (The Guidelines: Section 11.3).*

### Market pricing

The price at which tenure rights trade is a key piece of market information. It reassures sellers that they are not underselling and buyers that they are not overpaying. If market participants are unaware of prices being agreed in a market, it can become inefficient and even stifled because people do not know how much they can buy or sell land and property for.

In a food market, where goods are on display, many buyers and sellers meet and prices are negotiated openly; market pricing is straightforward. By means of comparison, buyers and sellers can easily determine a fair price for any particular quantity and quality of goods. However, tenure rights are different. Unlike fruit and vegetables, they are complicated and varied and do not trade as frequently. Prices are much harder to detect and specific details of each transaction can be difficult to determine. This is particularly so in the case of customary rights and informally occupied land. Valuations, which are estimates of prices, fill these gaps; they are substitutes for transaction prices.

There are two main types of markets in tenure rights, capital and rental markets. Capital markets refer to the sale of tenure rights in a "once only" transaction, the value of the tenure rights are encapsulated in a capital sum, usually but not necessarily a financial payment.

Rental markets refer to the leasing of tenure rights, usually a transfer of time-limited occupation and use rights in return for a regular payment of rent. Landowners wishing to lease their tenure rights may seek advice regarding rent and other key lease terms. For example, over 70 percent of land in Botswana is held under customary tenure; land boards allocate land on 50-year renewable leases with five-year rent reviews. In Mozambique a proportion of the rent goes to Federal government, part goes to the local government and part to the community.

A tenant may wish to transfer a lease to another party and there may be value that can be realized in the form of a capital sum or premium. Tenure rights that are held jointly – a married couple for example – may need to be valued to ensure an equitable distribution of wealth; valuations for family purposes are a frequent requirement.

Each agreement between parties to transfer tenure rights, whether permanently or for a period of time, should be negotiated freely and openly between informed market participants.

State law sometimes limits the scope for land transactions by defining the type of people that are eligible to be a party to a transfer. For instance, individuals and households that do not directly engage in farming may not be allowed to lease agricultural land. This limitation on the size of the market reduces the value of agricultural land.

When tenure rights are traded there are often transaction costs to pay. These might include a registration fee, stamp duty, transfer tax and legal, professional and brokerage fees, and can be substantial. High fees can suppress market activity, may discourage registration of tenure rights and distort the market through under-declaration of transaction prices as a means of evading high fees. Valuers must be careful to distinguish what appears to be "under-reporting" from legitimate declaration of transaction prices. Lowering transfer tax rates can reduce under-reporting, and effective mortgage markets can create an incentive to report actual prices in order to maximize loan amounts.

**Transaction charges**

The transfer tax in Poland is set at a low rate and is payable on market value rather than the declared sales price. Usually, notaries are in a good position to advise parties if their declared price differs significantly from that level. Tax authorities have five years to reassess the tax if necessary. They can require the taxpayer to adjust the declared price and order an individual valuation if necessary. If the valuation differs by more than 33 percent from the declared price then the taxpayer can be charged additional payments, including the cost of a valuation.

## Large-scale land acquisitions

*“ States should establish policies, laws and regulatory systems and agencies to ensure transparent and efficient market operations, to provide non-discriminatory access, and to prevent uncompetitive practices (The Guidelines: Section 11.3).*

Investors, often from nations that are capital rich but land poor, are acquiring large tracts of rural land, particularly in the global south. Motivated by financial returns as well as concerns about food and energy security and the effects of climate change, these investors have the financial resources to acquire thousands of hectares of land for food, biofuel production and the extraction of natural resources. Acquisitions are often encouraged by recipient states, which regard them as a key component of agricultural and economic restructuring.

Large-scale land acquisitions can disproportionately impact rural poor. Indigenous and often-vulnerable people who lack formal tenure rights but consider the land to be a common resource, may occupy affected land. Small-scale subsistence farmers and pastoral communities may be particularly at risk, as they need a lot of grazing land, and may lack formal rights of ownership and use.

The participation of all stakeholders, including holders of customary and informal tenure rights, ensures that market and non-market value are taken into consideration when these rights are affected. Forests, in particular, offer a wide range of valuable economic, social and environmental benefits. It is also important to have good access to information on transactions, prices and values so that consultation with local communities and civil society organizations is transparent and the opportunity for malpractice is minimized. Transaction information should relate to sales, leases and concessions so that various means of transfer can be considered. From the perspective of local communities, arrangements that are time-limited and do not involve the outright sale of ownership rights are preferred.

While compensation for state expropriation of land is often regulated in some way (see Section 3.4 below), acquisition of land by large-scale investors is often left to individual negotiations that can escalate into contentious disputes, including violent actions taken by “dispossessed” holders of tenure rights. Objective and impartial valuations can play a vital role in these negotiations. From an investor’s perspective, valuations help determine whether the acquisition might yield a viable return, but, more generally, valuations can ensure that all holders of tenure rights affected by the acquisition are fairly remunerated, including individual and communal holders of customary and informal tenure rights.

**Responsible governance of tenure: a technical guide for investors** (FAO, 2015)

The valuation of land and property is important when tenure rights are being acquired for agricultural investments. Valuation informs the negotiation process between parties, and appropriate systems should be developed to provide valuations that are fair and timely. These systems should be underpinned by national standards for valuation that are consistent with relevant international standards.

Increasingly, rural land is being registered with more comprehensive tenure rights for indigenous people and local communities. In India for example, Scheduled Tribes and Other Traditional Forest Dwellers are formally recognized. Non-state rural land may be held by families or by local communities (so called “commons”). There

are also periodical customary grazing rights conferred to pastoralists and there are tenants renting community land for agricultural purposes. Investors interested in diverting these lands to non-agricultural use must identify the holders of these customary rights, regardless of the formal status of land.

In situations where the State intervenes in the land acquisition process, perhaps because it owns land that is occupied by holders of customary tenure rights, it may agree a market price for the land with a large-scale investor but pay compensation to existing occupiers as an acquiring authority usually in pursuit of specific legislation. If the price agreed with the investor and the compensation paid to the occupiers is significantly different, this is likely to lead to dispute. Remuneration for land purchased through open market negotiation and compensation for compulsorily acquired (expropriated) land should be compliant with the following international guidelines:

**FAO.** 2014. *Respecting free, prior and informed consent: practical guidance for governments, companies, NGOs, indigenous peoples and local communities in relation to land acquisition.* Rome.

**International Finance Corporation.** 2012. *Performance Standards on Environmental and Social Sustainability.* Washington, DC, World Bank Group.

**Viitanen, K., Falkenbach, H. & Nuuja, K.** 2010. *Compulsory purchase and compensation: recommendations for good practice,* FIG Commission 9 – Valuation and the Management of Real Estate, Publication No 54. Copenhagen, International Federation of Surveyors (FIG).

**World Bank.** 2012. *Land acquisition and involuntary settlement. Performance Standard 5.* Washington, DC.

**USAID.** 2015. *Operational Guidelines for Responsible Land-Based Investment.* Washington, DC.

For a more detailed discussion of expropriation and valuation for compensation see Section 3.4 below.

It is also important to note the point made in Chapter 1 about value being context-specific. Tax valuations are not the same as market values because they are usually estimated using mass appraisal techniques (see Section 3.5) and may have been estimated some time ago. Rural land should not be advertised to investors at tax values as a means of attracting large-scale land acquisitions, nor should occupiers be compensated at tax values.

The extent of remuneration and compensation will depend on the degree to which tenure rights have been affected. Those in a local community for example, stand to lose some or all of their rights, which are the basis of their subsistence and livelihood. They may also lose social and environmental benefits. These benefits could also be affected by those beyond the local community and external to the acquisition site and yet impacted by it. It is useful to maintain this local/non-local split because there may be different interlocutors to deal with. The local community, which experiences the strongest impact of the land acquisition project, may enter into an interactive "community development agreement" with the purchaser. The non-local community, which experiences a weaker and less direct impact, could be represented by a body that receives collective payment for negative social and environmental impact, either as prescribed by law or through negotiations.

A single sum payment at the point of acquisition may not be the best means of remunerating holders of existing tenure rights. It can be extremely difficult to predict the revenue-generating potential of the acquired land following investment and improvement. Put simply, the market value of the land is very uncertain. If those who have had tenure rights affected find that their remuneration was much lower than later market values then this can lead to dispute. Regular payments or in-kind compensation spread over time may be more appropriate, especially in subsistence economies, where non-monetary benefits such as employment, training and improved infrastructure may be more highly valued.

Where resettlement is unavoidable, payment in-kind may require identification and provision of land of equal or greater productive value than that which is being acquired. Whatever the form of remuneration, it should be agreed in writing with all legitimate stakeholders and care should be taken to ensure that such agreements are contractually enforceable.

## Market monitoring

Compared with markets in equities and bonds, tenure rights trade infrequently: one of the purposes for valuations is to help improve market efficiency by filling in the information gaps that result. This is vital to buyers and sellers as it helps them trade more effectively, but valuations can also be used to monitor market activity more broadly. Reporting key items of market information – including trading activity, prices and valuations – helps reduce volatility, can identify potential mispricing, aid market forecasting and policy-making, and goes at least some way to reducing the potential for corruption and fraud.

The establishment of a value-based land and property tax requires the state to produce a set of valuations that are publicly available (see Section 3.5 below) and this is a good starting point for the publication of official statistics on the value of tenure rights.

Formal recognition of a valuation profession can encourage dissemination of market performance indicators, and the publication of market intelligence and statistics can be very useful to policy makers and advisors. Moreover, an active valuation profession can be a valuable resource to help undertake real estate tax assessments.

## 3.4 Regulated spatial planning

SCENARIO: A small island state has been preparing a detailed planning policy for 30 years but, for various political reasons, the plan has never been fully adopted. The state owns a large proportion of land on the island, much of which is covered with forest. Over the years there has been widespread unregulated development on this land. There has also been unrestricted urban sprawl around the main towns. The mountainous nature of the terrain means that infrastructure (especially road building) is difficult and expensive to upgrade, especially with informal development taking up most of the level ground. Consequently, there are problems with congestion, pollution and traffic accidents, there is little separation of incompatible land uses and environmental degradation is widespread. These problems are having a substantial impact on land and property values, suppressing them to the point where inward investment is negligible, a major problem for an economy that is heavily reliant on tourism.

*"Regulated spatial planning affects tenure rights by legally constraining their use… states should conduct regulated spatial planning, and monitor and enforce compliance with those plans, including balanced and sustainable territorial development (The Guidelines: Section 20.1).*

Regulated spatial planning policy determines the way that land is used and this has a significant impact on the value of tenure rights.

### Planning

A key concern for all states is how to manage land resources efficiently. Some land may be suitable for agriculture, other land for urban settlement. Infrastructure needs to be planned, natural resources sustained and the population protected from disasters, invasion and disease.

The value of tenure rights is one means of allocating land to its optimum economic use. Land values are highest in the centre of populous and accessible urban areas, and the rational economic response is to build more densely and use space more intensively in these locations. Similarly, highly productive farmland and forestland close to market are valued highly and farmed intensively.

**Master-planning and valuation**

Colombia has introduced a new planning framework that requires each city to produce a Master Plan. The law promotes revenue-raising tools such as local property taxes and capturing increases in land value that result from the grant of development rights. Familiarizing valuers with the new framework has been a critical task. The law regulates the valuation profession, establishing procedures, techniques and information requirements for the valuations. Valuers have organized themselves into city-specific professional associations, distributing work among their associates and educating members about the content and implications of the planning framework. In urban areas, even in developments with an informal origin, valuers have been collecting market information and, as a result, valuations have become more accurate.

Planning policy can include various redistributive reforms including land readjustment (land consolidation and land exchanges), land restitution (including transfer of public land to private ownership) as well as expropriation of private land for public purposes. The Guidelines include specific guidance in relation to redistributive reforms:

> *States may consider allocation of public land, voluntary and market based mechanisms as well as expropriation of private land, fisheries or forests for a public purpose (The Guidelines: Section 15.1).*

> *Financial and other contributions expected of beneficiaries should be reasonable and not leave them with unmanageable debts. Those who give up their tenure rights to land, fisheries and forests should receive equivalent payments without undue delay. (The Guidelines: Section 15.4)*

### Policy monitoring

Markets are able to provide a suitable environment for the delivery of many products but they are not so good at providing public services such as infrastructure, health and social care, and are not good at reducing the level of negative externalities (congestion, pollution, poor working environments, etc.) that are associated with some commodities delivered by the private sector.

Many jurisdictions around the world are wrestling with the problem of how to harness markets to allocate resources to their optimum use, but at the same time protect the public from the excesses of the market. The challenge is to introduce appropriate planning regulation that is not so bureaucratic that it stifles the innovation that markets can provide. Valuers can monitor how a market reacts to changes in regulation – perhaps an increase in the cost of house construction due to more stringent environmental regulations reduces the value of housing land. This information is useful to policy makers, regulators and consumers when assessing the impact of regulated spatial planning.

## 3.5 Expropriation

SCENARIO: In a country with a large rural population, hundreds of large-scale commercial farms covering millions of hectares of land were expropriated by the state to be redistributed to others. However, the assessment of compensation has been subject to delays and, in many instances compensation has not yet been paid to the owners. In the past these farms were bought and sold in a formal land market so many of them had been surveyed, registered and issued with title deeds. It is also possible to track the historical valuations owners had commissioned when they used farms as loan collateral. In anticipation of compensation, former owners created a database containing details of improvements on the farms at the time they were acquired. However, delays in compensation payments mean that many

of the farms have changed significantly. Separating the original improvements to be compensated from new ones will be problematic and time-consuming. Delays in compensation payments have also lead to significant interest costs and have made it difficult to identify owners who have since left the farms.

*“ States should provide prompt, just compensation where tenure rights are taken for public purposes* (The Guidelines: Section 3.1.4).*

*“ Subject to their national law and legislation and in accordance with national context, States should expropriate only where rights to land, fisheries or forests are required for a public purpose (Guidelines: Section 16.1).*

*“ States should ensure a fair valuation and prompt compensation. The compensation may be in cash, rights to alternative areas, or a combination (The Guidelines: Section 16.3).*

*“ To the extent that resources permit, states should ensure that implementing agencies have human, physical, financial and other forms of capacity (The Guidelines: Section 16.4).*

*“ All parties should endeavour to prevent corruption, particularly through use of objectively assessed values, transparent and decentralized processes and services, and a right to appeal (The Guidelines: Section 16.6).*

* Usually defined in law and chiefly involving infrastructure development. It is widely agreed that it does not include development for private gain

The use of expropriation powers can have a substantial impact on the livelihoods of those affected. Tenure rights might be expropriated by the state for many reasons, for example, to make provision for infrastructure and other development projects, to plan new areas of urban settlement or to reallocate tenure rights for restitution or consolidation purposes. Technical guidance on expropriation procedures can be found in *Compulsory acquisition of land and compensation* (FAO, 2008). While in theory the optimal resolution of any expropriation would be replacing the expropriated rights by allocating similar rights over similar resources in similar locations, in practice this option is often not available. Therefore, the focus here is on estimating the amount of compensation.

When assessing fair compensation, the aim is to place the affected party in a position after expropriation that is no better or worse than before. Valuations are integral to this aim and the following general guidelines can be stated:

- Independent and impartial valuers should be appointed to value expropriated tenure rights and any reduction in the value of land affected by expropriation.
- The valuation process should be participatory and minimize conflict and stress on affected parties.
- If an affected party wishes to appoint a valuer to value affected tenure rights, the cost should be borne by the expropriating authority.
- The process should provide for resolution of disputes over value and the valuation process.

- If the acquiring authority is empowered by a specific law, the valuation date should be set by law, not by the acquiring authority.
- Valuers should ensure that compensation is fairly and expediently agreed, and:
  - provide, if possible, an early indication of the amount of compensation likely to be awarded;
  - base estimates of market value on openly agreed transaction prices where possible. (Noting the comment in Chapter 1 regarding the context–specific nature of value, compensation should not be based on values set by the state for other purposes such as land and property taxation as these may not fully reflect the "loss" of tenure rights);
  - take non-market value into consideration.

The overall aim should be to ensure that participants are at least as well off after expropriation as before. Valuations based on "before and after" redistributive reform programmes can help ensure a fair transfer of tenure rights.

Usually, when tenure rights are expropriated, compensation is payable in respect of rights taken or extinguished, the effect on any retained rights and for losses to the livelihoods of affected parties. Compensation may also be paid to landowners where no tenure rights have been acquired but where there has been a reduction in value as a result of nearby public works, such as noise from a new road. Valuations are required to quantify all of these items and include assessments of market and non-market value.

## Valuations for expropriation

### a) Valuing tenure rights that are to be taken or extinguished

Expropriation legislation should state what tenure rights can be expropriated and which are entitled to compensation. These will include perpetual and terminable rights. For the latter, it will be necessary to determine the earliest termination date. Compensation would then be assessed on the basis of any rental profit that the tenant may enjoy until termination plus the value of any improvements that have been made at the occupier's expense.

In the case of land and property where more than one party holds tenure rights, some means of allocating compensation will be needed. For example, a landowner may lease land to a tenant who then subleases to sharecroppers. Each interest can be valued individually and compensation estimated accordingly. However, there may be additional value attributable to the land or property if one or more of these interests were to be merged. Some means of allocating this synergistic value will be necessary and should reflect the value of both the land and improvements to the land, including crops. An investor landlord whose tenure rights have been expropriated should be able to claim for the costs of reinvestment in another property.

There should be compensation for occupation agreements that are less formal than a lease, such as licences to occupy and rights to use. Compensation should cover

the cost of relocation, disturbance and any loss of goodwill. These are sometimes referred to as a disturbance payment as opposed to disturbance compensation because the affected party has not had an interest compulsorily acquired but has been dispossessed.

Legislation generally does not compensate holders of informal rights for the value of expropriated land but there may be compensation in respect of improvements made to the land. The extent of this compensation is likely to depend on the specific circumstances of the informal occupation, for example, duration, degree of permanence or extent of acceptance. If occupiers are to be relocated, then compensation should also cover all relevant costs.

In addition to infrastructure and public service provision, a country's land policy may permit economic development as a legitimate ground for expropriation. In such cases the affected party should be entitled to a share of the development value of the land (or land value uplift).

Special assumptions attached to the market value basis should prevent holders of tenure rights benefiting from value that could only be attributed to the actions of the expropriating authority, since it is not a component of value that the owner could have realized in the market. This is known as the "no scheme world" assumption. It can be difficult to obtain evidence of market values if the expropriation order has been around for a while because the impending project may have influenced values in the area over some period of time.

There should also be regard to the period of time for which occupied land would have likely remained available for its existing use and to the availability of other suitable land.

**Expropriation for economic development**

In Hong Kong, a statute was passed to enable private developers who had acquired 90 percent of the tenure rights in any redevelopment project to apply to the Lands Tribunal to force the sale of the remaining 10 percent. This encourages owners to settle by negotiation rather than hold out or "ransom" their land. This is an example of how minor adjustments to tenure rights can achieve policy ends (in this case, speeding up urban redevelopment).

### b) Valuing retained tenure rights

There may be situations where only a portion of a person's tenure rights is to be expropriated but the retained land becomes less valuable as a result, for example, a new road that severs a land parcel in two. Compensation should be paid for the reduction in value of the retained land as well as for land taken for the road construction itself.

The value of retained land may fall as a result of the construction of the road works, where rights of access are temporarily taken, or work causing noise, vibrations, fumes, artificial lighting or the discharge of any substance.

The value of tenure rights might be affected by easements or wayleaves that permit certain authorities to lay and maintain cables and pipes on, under or over land. Compensation is usually in the form of an annual rental payment plus, in some cases, compensation to cover land lost for crop production and extra costs associated with the presence of equipment.

### c) Valuing compensation for disturbance

The owner of expropriated tenure rights has the expense of finding new accommodation and moving. More importantly, livelihoods, social networks, family connections and a sense of belonging are all likely to be affected. As we have seen, compensation in respect of expropriated land is usually based on a definition of market value that assumes the seller is "willing" but this is not always the case and loss is suffered as a result of being dispossessed and having to relocate. To address this, compensation for disturbance should be paid in respect of:

- relocation costs if all land is expropriated, reorganization costs if only part of the land is expropriated, or total extinguishment costs if a business operation is to permanently close;
- loss incurred in relation to work-in-progress: In the case of agricultural land this would be the market value of trees and perennial crops and the value of the harvest for annual crops. Similarly for industrial processes this would be the value of any non-replaceable stock and unfinished production materials;
- loss of goodwill: this relates to financial value over and above market value that a person or entity may obtain as a result of owning or occupying the specific property. This usually manifests itself in the form of customer loyalty;
- other losses or damages suffered as a result of being forced to move.

**Compensation for expropriation**

In India the statutory right to compensation in case of expropriation provides for additional payment over and above market value for: damage sustained to crops and trees; damage sustained by severing land; damage sustained by injuriously affecting other property or earnings; reasonable relocation expenses; and diminution of land-based profits between publication (declaration to acquire) and possession dates. Final compensation can be increased by up to 100 percent through the imposition of *solatium*. In cases where no market value can be determined, the statute calls for state government to specify a price based on comparisons with adjoining areas. In this way, the sociocultural and heritage value of the land are factored into the compensation.

## Expropriation and non-market value

Although difficult to quantify, compensation for non-market value might take the form of a discretionary payment that would be dependent upon the length of time a claimant has occupied the land and inconvenience likely to be suffered when dispossessed. Issues related to cultural norms, values and beliefs, particularly in relation to customary land, should be taken into account.

Religious sites such as sacred trees, shrines and mountains have spiritual value to resident populations but they are not traded so there is no concept of value-in-exchange. An alternative basis of compensation is therefore required. This might be an equivalent building in the case of a meeting place for religious worship. Alternatively, the compensation might cover the expense of identifying and acquiring a new site plus the cost of constructing a suitable building and appropriate disturbance compensation. In

the case of burial grounds and other sacred places financial compensation is unlikely to be appropriate. Instead, avoidance and/or mitigation measures should be considered.

**Compensation for the expropriation of native tenure rights**

Australia recognizes native tenure rights and provides compensation when these rights are expropriated. In 2016 the courts held that compensation in respect of expropriated exclusive native title rights should be valued at the equivalent freehold value and non-exclusive native title rights should be valued at 80 percent of the freehold value. Non-market value, which was valued separately, took account of the non-exclusive or communal nature of the tenure rights. Compensation was assessed on the basis of the lost cultural and spiritual relationship over the past three decades and for an extensive time into the future. Three particular considerations were taken into account:

- the building of infrastructure on dreaming lines;
- the extent to which expropriation affected not just the land acquired but also native tenure rights in areas impaired more generally;
- the fact that each successive act of expropriation in the locality reduced the area over which native title rights could be exercised.

## Valuing customary and informal land for expropriation purposes

When valuing customary and informal land, all holders of affected tenure rights should be identified. The valuer should understand the relevant customs and practices and how these might influence or even facilitate markets in land and property.

If tenure rights are communally held, it is essential that value be attributed to the correct individuals in the correct proportions. Sometimes apportionment of financial compensation among members of a community may not be appropriate. Instead, it may be possible to offer to relocate a community to a suitable alternative site. Although disruptive, such an approach can help to retain community linkages.

If the land can be leased from the community rather than expropriated outright, this can also help the community retain some link to their land. Compensation would be based on a temporary loss of rights and benefits. A solution of this type might be more appropriate for shorter, fixed term projects – expropriation of mining rights for example. An alternative solution is a profit sharing arrangement (see Section 3.2 above).

If part of a community's land is to be expropriated, in addition to compensation for land taken, it may be possible to agree on a programme of mitigation that could include additional community facilities such as education, healthcare, infrastructure and amenities on the retained land.

Informally occupied land can be especially challenging to value. Dwellings may have no addresses so identification is problematic. Establishing the size of land holdings requires physical measurement but some places may be difficult to access. If land holdings are occupied by extended families, it can be difficult to establish the legitimate recipient of compensation and disputes can result. Due to the lack of market price information, engagement and consultation are essential to reach a consensus on what is to be compensated and how much the compensation should be. Compensation need not be monetary, especially in informal markets.

**Valuing informally occupied land**

In India the statutory right to compensation in case of expropriation provides for additional payment over and above market value for: damage sustained to crops and trees; damage sustained by severing land; damage sustained by injuriously affecting other property or earnings; reasonable relocation expenses; and diminution of land-based profits between publication (declaration to acquire) and possession dates. Final compensation can be increased by up to 100 percent through the imposition of *solatium*. In cases where no market value can be determined, the statute calls for state government to specify a price based on comparisons with adjoining areas. In this way, the sociocultural and heritage value of the land are factored into the compensation.

Whatever approach or mix of approaches to estimating compensation is used, negotiations should proceed sensitively and with due regard to the non-market interests of the holders of customary tenure rights. Consultation with affected communities should take place from an early stage and involve men and women. Affected parties should be made aware of the compensation guidelines, preliminary compensation figures and their right to object if they feel that the amounts offered are not fair. Disruption to livelihoods should be minimized and affected parties should be placed in the same position as before, or better. This requires compensation for loss of use rights, such as cropping and grazing, and for non-transferable or permanent improvements, including buildings, wells, boreholes and fruit trees. Compensation for cropping land may be limited to the cost of preparing virgin land, including debushing, clearing, stumping and surface levelling. With regard to grazing land, compensation may be limited to legally fenced-off grazing land. Transferable improvements should be replaced on a "new for old" basis whenever possible. If rights holders are to be relocated, they should be offered a plot within the new scheme or alternative land of similar size in the vicinity.

Compensation should be paid before the acquiring authority takes possession and should include an allowance for disturbance. It is also important to ensure that payments retain their value in real terms by linking them to inflation. Procedures should be put in place to allow affected parties the opportunity to appeal to an independent body against compensation arrangements they have been offered.

**Appeal procedures**

In Namibia, the government valuation office undertakes all valuations concerning expropriation of communal land but any communal landholder who deems the amount of compensation to be unfair is entitled to object and demand a review. In preparing an objection and counterproposal for compensation, a communal landholder can enlist the services of a competent professional. However, the acquiring authority is not responsible for the cost of such services. In most cases communal landholders represent themselves or make group representations. If the acquiring local authority is unable to reach an agreement with the affected person, the individual case is referred to the Valuer General to review the determination of compensation for any possible errors or omissions. Most cases are resolved at this stage; however, some proceed to the courts and can remain unresolved for long periods of time. In such instances, the government discourages tenants being removed from land and property and prevents the acquiring authority from taking possession.

There is a need for fair and transparent policies and procedures for expropriation of land. Expropriating authorities must ensure that livelihoods of affected persons are not negatively affected by expropriation.

## 3.6 Taxation of land and property

SCENARIO: A property tax is assessed on the basis of the capital value of occupied property. Given the lack of comparable evidence, value is determined by referring to the replacement cost of improvements to the land. The law requires a general valuation every five years with supplementary valuations conducted annually.

The responsibility for undertaking the valuations rests with a Lands and Surveys Department and involves identifying new or altered properties, carrying out inspections, preparing valuations and reviewing valuation procedures. However, the Department only has three valuers and two technicians. This resource is insufficient to deliver general or supplementary valuations. Consequently, since the introduction of the tax in the mid-1980s, only one general valuation has been undertaken and the valuation roll (or list) has not been kept up to date. As a result, more than 100 000 units of land and property are missing from the valuation roll.

A major problem is the fragmentation of transaction information on land and property between eight local councils and a national Lands and Surveys Department. The latter has responsibility for the registration of leaseholds, whereas each council is responsible for registering freehold transfers, in effect, creating nine separate registration systems. The Lands and Surveys Department has no database of registered leaseholds and this makes it difficult to identify the number, size and location of registered properties.

Given the undeveloped state of the property market it would be a challenge to introduce a value-based property tax. There are no independent government statistics on prices or any indices tracking property value changes. There are no formal recording mechanisms in place to capture information on transaction prices and rents. The valuation profession is largely undeveloped and there are no university programs that could support the provision of graduate valuers.

> *Taxes should be based on appropriate values. Assessments of valuations and taxable amounts should be made public. States should provide taxpayers with a right to appeal against valuations. States should endeavour to prevent corruption in taxation administration, through increased transparency in the use of objectively assessed values. (The Guidelines: Section 19.3)*

Land and property taxes are used in many countries to raise revenue for central and local government expenditure. There are several types of tax, the main one as far as valuation is concerned is the recurrent (usually annual) ownership or occupation tax, usually assessed with reference to the value of land or the value of land and improvements. Other types of land and property tax are event-based and include *sales or transfer tax, capital gains tax, inheritance tax* and betterment tax. Consideration of these is outside the scope of this Technical Guide.

Valuers, whether public or private sector, form the body of knowledge, skills and experience that can be commissioned to produce and regulate tax valuations and assessments. The existence of a trained body of valuers is therefore central to the implementation and maintenance of land and property taxation.

## Implementing a land and property tax

### a) Define the basis of assessment

*Unimproved land value or improved land value?*

When implementing a land and property tax, a key decision is whether to base it on unimproved land value or the value of land plus improvements. There are strong economic arguments for a pure land value tax, but where land has been improved either by adapting the land itself for agricultural production or by adding structures, it can be difficult to value the unimproved land. If markets tend to trade in improved land then there will be little transaction evidence relating to unimproved land. Also, some improvements "merge" with the land (drainage, clearance, filling, levelling, etc.) and may have been made in the distant past. Usually, these sorts of improvements are included in the assessed land value.

**Valuing unimproved and improved land for tax purposes**

McCluskey and Franzsen (2001) explain the difficulties that can arise when trying to split real estate value between land and improvements to the land. In Western Australia, the definition of "unimproved land" was changed for urban sites so that it includes "merged improvements" whereas, in rural areas, unimproved land means land in its original state. Similarly, in New Zealand, merged improvements are regarded as part of the land value. In Jamaica, the increase in value afforded by the clearance of vegetation from a site is not regarded as an improvement. In Victoria, Australia, reference to land values has been declining as municipalities base assessments on the capital value of land in its improved state, the argument put forward is that these values are positively correlated with ability to pay.

In short, the basis of value should follow the market. Land value is usually appropriate for rural areas but does not work so well in urban areas where unimproved or cleared land is rarely transacted.

*Annual values or capital values?*

Annual rental values or capital values may be used as the basis for assessment. Capital values might be appropriate for agricultural land and annual rental values for commercial urban properties. In the United Kingdom of Great Britain and Northern Ireland for example, residents are taxed on the basis of capital values and businesses are taxed on the basis of rental values. The rationale for this is that dwellings usually trade in capital markets and business premises usually trade in rental markets, so these markets are where most of the transaction evidence can be found.

The basis of value is usually market value at a specified valuation date, subject to certain assumptions; an unencumbered vacant freehold interest or a leasehold interest let on "standard" lease terms for example. For agricultural land (including forests) a certain crop potential might be assumed. The taxable unit might be assumed to be in a reasonable state of repair and available for its current use only or for highest and best use (HABU). There may be exceptions for heritage properties and other uses deemed to be special and in need of protection against a higher tax burden that is often associated with the HABU assumption. In such cases, existing use value might be assumed.

*Market values or value-influencing attributes*?

Market prices reflect the benefits of location, quality and land use, so a tax based on market prices and values is equitable because it reflects ability to pay and reflects movements in the market (so long as regular revaluations take place). But some countries do not have sufficiently active land and property markets capable of generating sufficient transaction information. Instead, value-influencing attributes are used such as size, location, land use and cost of improvements to the land.

A tax based on physical attributes of land and property such as size of buildings or area of land is not so good at reflecting ability to pay, nor is it so good at capturing the "value" that results from infrastructure investment. However, it is more straightforward and less costly to implement than a value-based tax, particularly in developing countries, as it is less reliant on specialist resources and expertise (Bell *et al.,* 2005).

A flat-rate land tax is unable to reflect the varying quality of agricultural land or the ability of titleholders to pay different amounts depending on the revenue-raising potential of their land. If the tax is enhanced to take into account area-based value differentials with adjustment for size of parcels, land use and location this can improve tax revenue. If and when transaction prices are properly recorded these can be used to refine the model.

**Basing a tax on land and property features rather than value**

The Jamaican Government has been formalizing the informal occupation of state-owned land. Using location, size, topography, and soil type as the main inputs, government valuers estimate the unimproved site value of each parcel and these form the basis of the sale prices for the occupiers. Approximately 1000 land titles have been issued to informal settlers and added to the property tax valuation assessment roll. Adopting a simplified site value approach has made it easier to undertake valuations, a particularly as market information is limited.

A refinement to this approach is the use of coefficients to reflect market differentials. These can be used to adjust the taxable amount according to land use type or location. Other commonly used factors are: access to water, soil quality and access to services such as schools and clinics. An area-based tax such as this can be considered as a first step towards a value-based tax as markets develop.

### b) Identify determinants of value and collect relevant information

Land use can be categorized to enable information to be collected at an aggregate level as well as at a taxable unit level. This is most reliably achieved by inspection but data may be collected from central and local government databases, brokers and agents, or from owners and occupiers via self-declaration. Transaction data can be obtained from notaries or solicitors. Sometimes mortgage valuations might offer a more reliable source of information than transaction prices reported for tax purposes. They also have the advantage of including attribute data as well as a transaction price (or mortgage value).

If improvements to land are taxable, details of those improvements believed to affect value will need to be collected. In the case of buildings, plant and machinery this will include size, type, age and condition. It is likely to be time-consuming and expensive to do this so it is important to ensure that the tax revenue base warrants this degree of data collection. The result will be a rich data set on real taxable units, which, if kept up to date, could be valuable for other state applications as well as market monitoring and benchmarking in general. Self-declaration of property characteristics can help when assembling data on land and property, but in many developing countries this can be difficult.

**Establishing a new land tax**

The Namibian Government decided to fund its land reform programme to redistribute agricultural land to previously disadvantaged citizens using a new land tax on owners of commercial agricultural land. A Directorate of Valuation was established, with a mandate to provide valuation services and implement the land tax. The enabling legislation provides a formula for determining taxable land values and methods for determining tax rates for different categories of agricultural landowners. The legislation also identifies the roles of government ministries such as Agriculture and Finance in the implementation of the tax.

A multidisciplinary team was assembled, comprising valuers, planners, land surveyors, agricultural and GIS experts, together with external consultants. Donor and internal resources were combined to build institutional capacity to oversee the technical process. A parallel capacity building process at one of the country's academic institutions, together with overseas training of staff, ensured that the Directorate would have its own staff to conduct revaluations in the future.

Throughout the process, from data collection to the valuation court appeals, the Valuation Directorate engaged key stakeholders including government ministries, the two main farmers' organizations and individual farmers. Using information from the Land Register, the Directorate produced a database of all farms in the country (subsequently, this database became the initial dataset for the computerized deeds registration system). A verification exercise was undertaken, combined with a media campaign, calling upon farmers to confirm details of their farms. By the time the Valuation Roll was published, 85 percent of the farms had complete and verified information.

Records of property transactions maintained by the Registrar of Deeds were used to obtain sale prices of farms transacted during the three years preceding the valuation date. Because the tax is based on unimproved site value, the value of any improvements needed to be deducted from these sale prices. Inspection teams visited a sample of farms to inspect improvements. The depreciated cost of any improvements was deducted from the sale price to produce a residual amount paid for land in its unimproved state. The residual amount divided by the farm size in hectares was used as a unit of comparison (price per hectare) to create a schedule of unimproved site values. These values were mapped and value zones were delineated. This provided the basis upon which the farms were valued.

The provisional valuation roll was put on public display and only a small number of objections were received and these were settled in the Valuation Court over a period of ten days. There followed the implementation of a digital cadastral system, computerized deeds registration system, computer-assisted mass valuation system, a land tax payment and reconciliation system, as well as data exchange and sharing arrangements between the systems. These systems have made it straightforward for valuers to maintain the valuation roll and conduct revaluations. Since its inception the land tax has yielded average annual revenue of approximately US$2.8 million.

### c) Value each unit

Valuing unimproved land can be less onerous and less resource intensive than valuing land plus improvements. Factors that influence the value of rural and agricultural land are likely to be fewer in number and more easily quantifiable than urban land uses. The main influence on value is likely to be the size of the land parcel and that can be accounted for by estimating a value per hectare. There are likely to be fewer transactions (land holdings are larger and trade less frequently than in urban areas) but this is not a significant problem because land uses are likely to be less diverse in rural areas and land values tend to be more uniform over space.

Valuations may be undertaken individually or by developing a mass valuation model. Mass valuation or mass appraisal is widely used to value residential dwellings for tax purposes because tenure rights are relatively homogeneous and there is usually sufficient sales evidence, particularly for certain types of dwelling such as apartments. Mass appraisal can also be used to value agricultural land despite low sales activity because market areas are likely to be much bigger and it is possible to gather sales evidence over these larger areas. Also, the number of explanatory variables is likely to be smaller.

To summarize, the introduction of any tax requires political commitment and consultation with stakeholders. It is important to establish appropriate policy, legal and institutional frameworks to support the technical aspects of the tax, and capacitate valuation and administration institutions to provide appropriate technical leadership. Temporary measures, through engagement of consultants, may be necessary where staff shortage is critical. Unambiguous identification of taxable units is essential and a comprehensive database of taxable properties must be created. The development of land administration systems including cadastral, registration and valuation facilitates updates and production of valuation rolls. Finally, there must be an opportunity to appeal against valuations in a friendly tribunal that allows parties to represent themselves.

## Maintaining a land and property tax

### Revaluations

Infrequent revaluations can result in substantial changes in tax liabilities, which can be politically unpalatable. Frequent revaluations or a form of interim indexation of values can help to smooth the increases. Regular revaluations also ensure that relativities between localities, land uses and different rates of increase or decrease in value for properties of different prices or rents are maintained. It also means that State and local valuers are not left with periods of little or no work, which is inefficient and may lead to a depletion of skilled valuers. This could lead to a spiral of incapacity, with revaluations postponed owing to lack of resources and personnel.

It may be practical to adopt a rolling programme of inspections and revaluations, perhaps revaluing properties of a similar type at the same time and then selecting another type the following year. Links to other land administration functions are invaluable for revaluations – access to an up-to-date record of sales and lettings being an obvious benefit, but also access to information data on land use planning and building approvals would strengthen the quality of data being used to assess values.

### Capacity

Depending on information requirements, the data availability and valuation approach adopted, a network of offices (including valuers and administrators) may be required. State valuers, independent valuers operating under contract, or a combination of the two, can undertake tax valuations. The key to reliable valuations is localized market knowledge, so valuers should be able to access and analyse local market information. This is why, if the state operates the tax without private sector support, local offices or links with municipal governments are critical. Changes to the use of land or improvements need to be recorded and this is best done at a local level.

Computer-assisted mass valuations may require the use of technologies including geographic information systems, remote sensing, satellite imagery, aerial photography and crowd-sourced data sets, coupled with advanced statistical analysis. Consequently specialist skills may be needed and this requires forward planning and capacity building, as well as adequate budgetary planning.

### Governance

Although tax valuation is a part of an overall tax administration function, there are valid reasons for keeping it separate. The technical process of valuing taxable units of land and property can be kept separate from the more political decisions regarding the extent of the tax base (deciding what is taxable), policies in relation to exemptions and reliefs and rate setting (deciding the amount to be charged). In this way, the valuation function is distinct from billing and collection in order to ensure independence.

This approach also allows tax valuations to be undertaken locally, perhaps with an independent body to supervise and monitor the quality of the valuations. Valuers based

in local offices are able to liaise with other parts of local government and thus monitor changes of land use, subdivisions, consolidations and new developments. A strong central office is still important to prepare the valuation roll or list, maintain consistency, promote best practice, compile information from various sources and value specialized infrastructure. Whichever approach is adopted it is essential that adequate resources are available to set up and maintain the tax base.

Secure funding allows dedicated staff to carry out preparatory work to enable revaluations when required. A portion of the revenue generated by the tax can be used not only to provide local services but also to fund capacity building. In some jurisdictions, revenue is used to provide self-funding semi-autonomous valuation service agencies.

## 3.7 Accounting, lending and insurance

SCENARIO: The banking sector of a country would like to lend money to individuals and businesses. Unsecured loans are too risky but secure legitimate tenure rights could provide the necessary collateral for a significant volume of lending activity. The banks require impartial and objective valuations of these tenure rights to reassure themselves that they are valuable enough to cover the loan amounts. The government is keen for this lending to take place because it sees the economic benefits driven by the investment of the loan capital. However, it is also concerned that lending does not get out of hand, that banks overstretch themselves and are unable to meet depositor demands should the need arise. So the banking sector and the government see the need for valuations of land and property to underpin individual lending decisions and collective lending activity.

### Accounting

Regular valuations of state, community and privately owned tenure rights provide vital monitoring information for owners, occupiers and citizens. Commonly referred to as asset valuations, they ensure that the values of state-owned land and property assets are objectively monitored so that policy-makers can make informed decisions. They provide corporate entities with information on which to base their business decisions.

Often, asset valuations are included in the financial statements of state-owned enterprises and corporate entities. This may be to report the value (or carrying amount) of real estate assets in a balance sheet, to establish the value of assets that are to be acquired in a takeover or simply regarded as surplus to requirements and therefore being considered for sale. Financial statements also report any depreciation and possible impairment of assets. Buildings and leases are regarded as depreciating assets for accounting purposes so there is a need to regularly reflect their declining value in financial statements.

Improvements to land are usually traded with the land itself although for some purposes like financial reporting, it may be necessary to value land and improvements separately. The reason for doing this is because improvements can be depreciated (for tax purposes) whereas land cannot.

Asset valuations are also used to report the value of land and property held by institutional investors such as pension funds, unit trusts and life funds, usually on an annual basis. Insurance companies regularly revalue land and property investments to ensure they are complying with any statutory requirements to hold certain amounts of capital and encourage them to maintain a prudent spread of investments in relation to their liabilities.

International Financial Reporting Standards (IFRS) published by the International Accounting Standards Board, and International Public Sector Accounting Standards published by the International Public Sector Accounting Standards Board set out rules for financial reporting and there are a number of circumstances when valuations of land and property assets are required. Chiefly, valuations are required when reporting the carrying amount of land and property assets on a company balance sheet. International Valuation Standards (IVS) provide globally accepted guidance for land and property valuations that meet the requirements of IFRS.

## Valuation for the privatization of state assets

In recent years there has been a global trend towards states reducing their participation in commercial activities, in particular, by selling off or privatizing state-owned enterprises (SOEs). SOEs may range from profit-making telecom companies to loss-making heavy industries, from successful state-run farms to abandoned state land occupied by informal settlements. Governments may require valuations in advance of the sale of an SOE, to provide an indication of the expected price or as a basis for setting a reserve minimum price, or subsequent to receiving offers as a means of validating the price. There is particular need for caution in the valuation of the land and property of an SOE in such circumstances.

Where an SOE is a 'going concern', the sale price should be based upon its business value. Business valuations are normally undertaken by specialist firms of accountants and based upon complex calculations of potential profitability, using techniques such as price–earnings ratios, discounted cash flow, etc. The asset valuation supports the business valuation and should reflect the contribution of the land, buildings and machinery to the potential profitability of the enterprise. In line with IFRS, asset valuations are often valued on the basis of depreciated replacement cost (DRC). It is important to note that assets which are held as investments or surplus to the operating requirements of the SOE must be valued at market value, being an estimate of the realisable sale price, rather than DRC.

Where an SOE is loss-making or producing relatively low levels of profits, the test of "adequate profitability" should be applied to ensure that the entity can support the DRC estimate. That is, asset values reflected in corporate accounts should normally be less than the value of the business (otherwise it would be unprofitable for the enterprise

to assemble those assets). If this is not the case, then this should sound warning bells as the assets may be "overstated" and may need to be "written down" for accounting purposes and/or the assets should be valued for sale for disposal (either collectively or individually on the basis of removal). It follows that, where the value of the assets for disposal is higher than the value of the business, the privatization should be based on the break-up value of the assets rather than the (low or even negative) business value. The significance of this is that there is the very real danger that the purchaser may subsequently run down and asset-strip the business, gaining profits that should have been accrued by the state.

## Lending

Legitimate tenure rights that are secure and transferable are widely regarded as suitable collateral for loans and a prerequisite to an effective real estate lending market. Indeed, the world's capital is increasingly invested in land, and as capital reserves grow but the supply of land remains fixed, this leads to rising land values. The ability to borrow using land and property as collateral helps release this capital. An important reason why property owners in informal settlements participate in property registration programmes is an expectation of improved access to more formal credit (Parsa *et al.,* 2011).

If (registered) tenure rights are being considered as security for a loan, a valuation determines whether those rights provide adequate financial security for the lender. If a borrower defaults on a loan the lender may wish to take possession of the tenure rights and sell them in order to realize their value and recover the debt.

Informal, non-cash lending is often prevalent in rural areas where banking penetration is weak. Lenders may charge high interest rates or even decide not to lend at all if they perceive the loan to be too risky. Lenders may be more inclined to lend if they are confident that the underlying tenure rights are sufficiently secure and fungible, and their lending criteria, such as loan-to-value ratio, income projection and credit rating, are met. Once a satisfactory level of tenure security is established, valuations of those tenure rights are essential for estimating key terms of a loan.

Depending on the size of the market and value of the tenure rights, mortgage lending can be a large component of economic activity in a country. It can also become a highly destabilizing influence in economies where real estate debt is a high proportion of total consumer debt. Strong regulation of valuations for lending purposes is vital to manage conflicts of interest and undue influence from stakeholders. A crucial valuation issue in this area is, therefore, governance (see Chapter 5).

As real estate markets evolve, tenure rights can become commoditized and progressively more complex and abstract. Separation of ownership and occupation becomes commonplace as investors increasingly regard tenure rights as a viable investment class. Similarly, the financialization of tenure rights typically begins with simple mortgage loans but, as markets mature, secondary mortgage products, securitized financial instruments and a growing interaction between financial markets and real estate markets emerge. Underpinning all of these secondary markets and derivative financial instruments are tenure rights that relate to land and property. Robust valuations of these tenure rights are essential if excessive financial market volatility is to be moderated.

### Insurance

Most land and property is insured against damage and destruction and valuers are required to estimate their replacement cost for insurance purposes. Valuations are also required in the context of disaster recovery. Before-and-after valuations help determine compensation for insurance purposes and they can be used to monitor the impact of ongoing blight on land and property values. Compensation needs to consider increases in value in non-affected areas as a result of demand from relocating businesses and households, and there may be short-term demand for housing disaster recovery workers, which can affect specific market sectors such as rented accommodation. Valuers may be subjected to pressure from affected landowners, state, insurance and lenders when undertaking valuations in this type of situation.

**Valuations in disaster recovery situations**

Naturally, valuations are not a priority in immediate post-disaster situations. However, during the reconstruction phase, it is often the valuer's responsibility to estimate the nature and extent of the replacement of the built environment and to determine where cost liabilities might lie. An example is the reconstruction of Christchurch, New Zealand, following the series of devastating earthquakes that occurred in 2011. There were two insurance-related challenges: first, insurance cover for most properties was specific to each building and did not cover damage to infrastructure. Consequently, payouts were not sufficient to replace the damaged infrastructure; second, reinstatement costs estimated by valuers were based on damage to single buildings only. The earthquakes caused such extensive damage that the local workforce was unable to cope and additional resources had to be commissioned. This led to significantly increased reconstruction costs, rendering insurance cover inadequate.

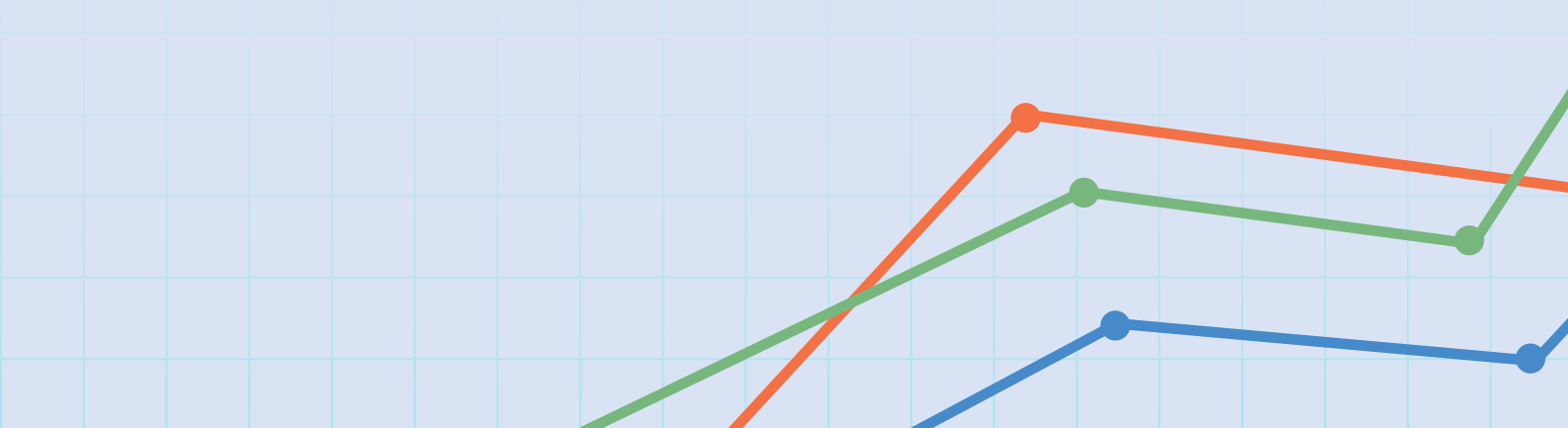
Particularly in disaster recovery situations, but also more generally, it is important for insurers, loss adjusters and valuers to work together to realistically estimate the nature of, extent of, and the liability for losses in relation to the built environment.

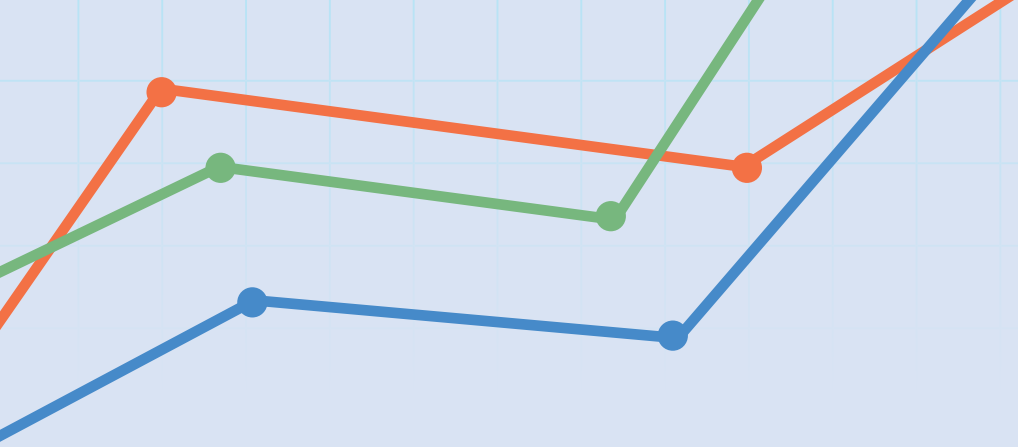
## 3.8 Summary

- ✓ Valuers should be able to value tenure rights in both capital and rental markets, and advise all parties on the key terms of sale and lease arrangements.
- ✓ States should consider carefully the level of transaction tax they impose as this can affect market activity and, if set too high, can lead to high levels of non-compliance.
- ✓ Valuers have a key role in ensuring fairness in negotiations related to large-scale land acquisitions and privatization of state assets. States should implement a robust policy and legal framework for privatization, with sufficient capacity to manage the process and provide adequate time for consultation with stakeholders.
- ✓ Valuations, together with relevant market information, provide important intelligence on which to base market monitoring, forecasting and land policy decisions.

- ✓ Valuers should therefore be consulted when formulating planning policy and be used to ensure fair transfer of tenure rights following redistributive reform programmes.
- ✓ Professional valuers should assess compensation in a participatory process, with a right of appeal to affected parties.
- ✓ Valuers should assess compensation for formal, customary and informal tenure rights that have been taken or affected by expropriation and in respect of associated disturbance and loss of livelihood.
- ✓ Valuers are central to the implementation and maintenance of land and property taxes.
- ✓ Valuers provide important information to lenders and borrowers about the value of tenure rights used as security for loans.
- ✓ Regular valuations of land and property assets are vital to companies, states and individuals so that they can make informed investment decisions and comply with financial reporting standards.

# 4
# What does a valuation involve?

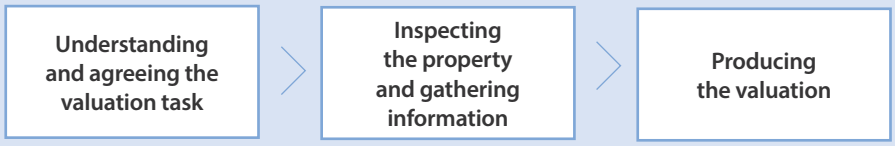




# 4. What does a valuation involve?

## 4.1 Key points

- The process of valuation typically involves understanding and agreeing the valuation task, inspecting the property, gathering and analysing comparable evidence, and producing the valuation itself. The steps can be codified in valuation standards as a way of promoting consistency in approach.



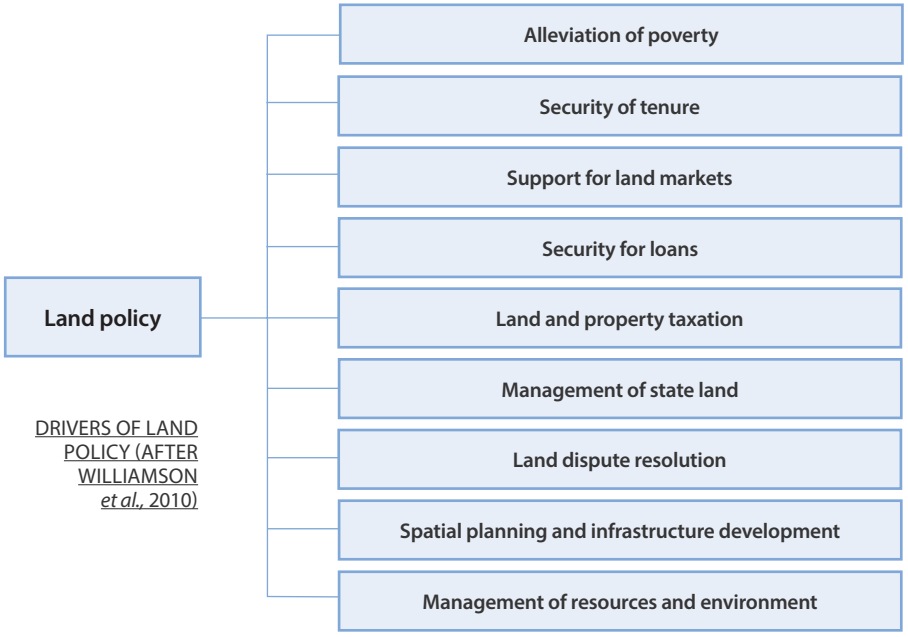

- While internationally-recognized valuation methods focus on market value as the most equitable and reliable approach to estimating worth, tenure rights are capable of bestowing non-market benefits on individuals, communities and societies. Consequently methods of valuing tenure rights that focus on non-market value are emerging.

- The estimation of non-market value relies on approaches and methods that attempt to either express social and environmental benefits in monetary terms or identify them so that they may be represented and accounted for in non-monetary terms. The methods are challenging to implement but are essential for capturing holistic expressions of value in society.

## 4.2 Background

It is important to place valuations into a context of land policy. Valuations play a vital role in land policy decisions:

- by providing estimates of transaction prices in land and property markets;
- assessing the value of tenure rights used as loan security;
- underpinning tax assessments;
- helping to optimize the use of state land;
- resolving disputes;
- analysing the value implications of spatial planning and infrastructure development.




DRIVERS OF LAND POLICY (AFTER WILLIAMSON *et al.*, 2010)

The relationship between land policy drivers and valuation is symbiotic. Active land and property markets and high levels of lending activity generate much needed information on market prices. The existence of a land registry, together with accurate, complete and accessible records of ownership of tenure rights is of paramount importance. State guarantee of the accuracy of land registry records or the availability of title insurance help reduce risk. The existence, predictability and enforcement of land use rules and zoning is especially important to valuation, as is the existence and enforcement of building codes and safety standards for buildings.

Similarly, business law, specifically legislation that relates to contracts, agency and tort will be highly influential on values and valuation practice. Taxation policy and related legislation are also relevant to valuation practice as they establish the framework and rules for tax assessment.

The degree to which these policies and laws influence valuation practice will depend on specific drafting. A precise definition of value may be stipulated, together with assumptions as to which factors must be disregarded or assumed, for example in the case of tax valuations or valuations for expropriation. Alternatively, definitions might be more loosely defined and the detail left for the courts to decide. It might be preferable for definitions to be left open to interpretation so that market participants can decide on precise terms that are pertinent at the time they are negotiated. Courts may intervene when clarification is required or in cases of disagreement.

Land and property markets, whether development, occupier, investment or finance markets, can be a major contributor to an economy. It is advisable, therefore, to have valuer representation at a senior level within government. Sometimes the more technical requirements for valuation are divided among a finance ministry (often responsible for

valuations associated with real estate taxation), central bank (valuations for lending), and land-related ministry or agency (which may be responsible for valuations for expropriation, state land management and so on). Valuer representation at a policy level, that can oversee these areas, is recommended. This enables crosscutting issues that affect values, such as a market downturn, currency fluctuations or political unrest, to be understood.

In Chapter 5, the components of an effective valuation system are considered. In this chapter, the stages of a typical valuation are explained:

- understanding and agreeing the valuation task;
- inspecting the property;
- gathering and analysing comparable evidence;
- producing the valuation.

## 4.3 Understanding and agreeing the valuation task

Valuations in the public sector – land and property taxation or expropriation, for example – are usually in response to statutory requirements and detailed instructions are often prescribed in laws and regulations. Private sector valuations, on the other hand, are likely to be motivated by market need. The valuation process and output are not set by statute, so it is vital that clients understand what they are getting when they request a valuation and have redress for malpractice should the need arise.

Before confirming a valuation instruction, it is important to understand the precise nature of the land and property interests to be valued and the reason for the valuation. This helps determine the size of the task, the type of valuation required and the method or methods likely to be used. It also ensures that the valuer is suitably qualified to do the job and helps detect any conflict of interest.

It is also important to determine which international and national valuation standards apply and whether the valuation will be affected by legislation or state regulations. For example, in some countries only qualified registered valuers are legally permitted to undertake property tax valuations.

## 4.4 Information gathering

### Inspection

Inspections and investigations are fundamental parts of the valuation process and should be undertaken in a logical and methodical manner and properly documented. A physical inspection usually precedes a valuation but is not mandatory; mass valuation for taxation purposes might well dispense with physical inspections of each taxable unit. An inspection should record the attributes described in Chapter 2, including:

**Nature and extent of tenure rights:** including details of any leases or subleases, easements and other legal rights, restrictions on, say, use or further development and any improvements that may have been made to the premises by a tenant.

**Characteristics of the locality:** in particular, the availability of infrastructure communications and other facilities that affect value.

**Physical nature and extent of the land and property:** including:

- dimensions and areas of land and buildings. Measurements should be in accordance with International Property Measurement Standards or nationally adopted measurement standards;
- uses(s);
- age and construction of improvements;
- description of accommodation, installations, amenities, services, fixtures, fittings, improvements, and any plant and machinery which would normally form an integral part of the building;
- the state of repair and condition of any improvements to the land, whether they have been adequately maintained and any basic defects;
- trade fixtures and fittings are normally excluded from a valuation unless the property is being valued as part of an operational entity.

**Running costs:** should be determined and liability for them identified, for example, when there is a separation of ownership and occupation via a lease.

**Planning and environmental issues:** These are important especially if the building is to be used or developed and include:

- abnormal ground conditions;
- historic mining or quarrying;
- coastal erosion;
- flood risks;
- proximity of high voltage electrical equipment;
- contamination (potentially hazardous or harmful substances in the land or buildings);
- hazardous materials (potentially harmful material which has not yet contaminated land or buildings);
- deleterious materials (building materials that degrade with age, causing structural problems)

## Secondary information

Information gathered from inspection should be supplemented by information obtained from the owner, occupier and other sources. These might include: remote sensing, satellite imagery and aerial photography; topographic maps, soil maps, zoning maps; cadastral and ownership records; registers of sales and lettings; previous valuations, surveys and inspections. It may be necessary to combine data sets if, individually, each contains some but not all of the information required. It is important to ensure, therefore, that individual units of land and property and individual tenure rights can be unambiguously identified.

Geographical identification need not be a postal address but can be unique identification codes, perhaps based on spatial coordinates. It is also important to share these identifiers so that data relating to the same land and property can be merged. It can be difficult to identify separately occupied parts of buildings such

as apartments and business premises so a robust data model is essential. ISO 19152:2012 Geographic Information – Land Administration Domain Model is a descriptive conceptual model that provides a reference for systems that describe relationships between people and land.

Valuers should take reasonable steps to verify any information relied upon. It is helpful in this respect if there is readily accessible information about the provenance of secondary data including its source, date collected, frequency of the update, and so on. Client information that is not in the public domain and which is obtained whilst valuing a property must be treated confidentially.

Information requirements for valuation centre on the need to understand the subject property, transaction activity relating to comparable properties and the wider market context:

**Information relating to the subject property includes:**

- tenure rights;
- current use(s): highest and best use, other planning details;
- plot details: address, size, (location in relation to) utilities and services, etc.;
- improvement details: size, number, type, age of buildings, etc.;
- maintenance and condition (maybe separated as exterior and interior) and quality.

**Information relating to transactions of comparable properties includes:**

- quality and availability of pre-sale information;
- fairness and confidentiality of bidding process;
- type of transaction: arm's length, gift, etc.;
- transaction costs;
- address;
- date;
- price;
- ownership and tenure details, including lease terms where applicable.

**The wider context includes**:

- market size and type;
- stakeholders: occupiers, investors, dominant tenure pattern (state-owned land, number of parcels by type, number registered, etc.);
- transaction activity (number of transactions per annum and as a percentage of stock);
- type of transactions: capital or rental, by sector (agricultural, commercial, residential);
- prices: rents and capital values;
- development activity (new supply, take-up, removal of old stock);
- vacancy levels;
- lending activity (percentage of stock subject to a mortgage, loan-to-value ratios, finance rates);
- supply and demand: economic and social influences, competition.

Information should be as timely (up to date), comprehensive (extensive coverage) and as detailed as possible. This is easier stated than achieved, even in countries with the most developed markets in tenure rights.

## 4.5 Undertaking the valuation

### Bases of value

The precise definition of value on which a valuation is based is referred to as the basis of value. It is usually accompanied by a set of assumptions that refine the definition. To avoid ambiguity, International Valuation Standards (IVS) provide a conceptual framework and explain the meaning of valuation bases in precise terms. The standards ensure that consistent bases of value and valuation assumptions are applied. Other definitions of value may be prescribed legally at the national level. The basis on which value is estimated should be made clear in the valuation.

#### Market value

The most widely used basis of value is market value, defined by the International Valuation Standards Council (IVSC), and its annualized equivalent market rent. These bases correspond to the economic concept of value-in-exchange. Specific tenure rights will have different values-in-use to different people but in a market, the expectation is that participants converge on a value-in-exchange consensus.

**Market value:** the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller, in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

**Market rent:** the estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms, in an arm's length transaction, after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.

Market value (taken to include market rent henceforth) is not a fact but an estimate based on a model of the market. It is the most probable price, reasonably obtainable in an open market and reflecting highest and best use (HABU), in other words, that use which maximizes potential whilst being possible, permissible and financially feasible.

Market value may include synergistic value. This is value that can be attributed to the merger of two or more physical real estate assets or two or more sets of tenure rights. The assets might be adjacent land parcels on a development site or they might be superior and subordinate tenure rights in the same property. Synergistic value exists if the combined value of the real estate assets or tenure rights is greater than the sum of the individual interests.

Market value does not include any element of special value, that is, value to a special purchaser over and above value to the market in general. This might include

a price inflated or deflated by special circumstances such as unusual financing arrangements or a relationship between the parties to the transaction. Special value may be reported separately from the market value estimate.

There are two further internationally recognized bases of value defined by the IVSC, investment value and fair value.

**Investment value:** the value of an asset to the owner or prospective owner for individual investment or operational objectives.

**Fair value:** the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

Investment value represents value to the owner or prospective owner. In developed economies at least, this value is mainly economic or financial, representing the worth of a property, either as an investment or as part of an operational entity.

**Market value and investment value**

In some countries it can be difficult to apply the IVSC (International Valuation Standards Council) definition of market value because the trading of tenure rights is restricted in certain ways. For example, it may not be possible to sell tenure rights and so market value may be impossible to determine. Use rights may be restricted, so it is not possible to determine HABU. Such tenure rights could be valued on an investment value basis instead, given that the value is specific to the current holder. Alternatively they could be valued assuming existing (allocated) use granted to another user through payment of a premium.

At first sight the definition of fair value appears similar to the definition of market value but there are two distinctions. First, although the parties may be unconnected and negotiating at arm's length, the property is not necessarily exposed to the wider market. Second, the price agreed may reflect the specific advantages (or disadvantages) of ownership to the parties involved rather than the market at large. An example would be the price agreed between a landlord and a tenant for the extension of a lease. Fair value can include special value.

## Non-market value

*"Policies and laws related to valuation should strive to ensure that valuation systems take into account non-market values, such as social, cultural, religious, spiritual and environmental values where applicable (The Guidelines: Section 18.2).*

Non-market value is recognition of the significance that people ascribe to tenure rights that is not capable of being expressed in economic terms. It reflects social and environmental benefits associated with holding tenure rights. Acknowledgement of this non-market value is essential when assessing compensation for expropriated tenure rights because the affected party is not a willing seller and therefore market value (an estimate of value in exchange) does not fully reflect value-in-use.

In many societies, holders of tenure rights are custodians of a scarce resource. Market value is only one – economic – approach to measuring that resource; it

ignores social, cultural and environmental values. For example, if tenure rights are to be expropriated from an owner, the relevant legal framework may state that the amount to be offered should be based on a value that would be agreed on the open market between a hypothetically willing buyer and seller. The actual seller, however, may have a notion of (non-market) value that is in excess of market value. If this excess could be quantified in economic terms, it would represent the amount above economic value that is required to compensate expropriated holders of tenure rights. Yet, attempting to distil these non-market attributes into economic terms might mean their intrinsic worth in enhancing quality of life is not adequately reflected. Consider how the value that a community group might ascribe to tenure rights, held in trust on behalf of future members, might differ from the value assigned by an investor.

To an extent, the IVSC definitions of market value and investment value recognize non-market value insofar as they do not confine themselves to a monetary amount and imply that processes and relationships, for example, skills, as well as material objects can have value. But the Guidelines go further; Section 18.2 recognizes that there are values for which and with which people may trade, but that some values are not traded at all. These social, cultural, religious, spiritual and environmental values constitute an important part of a person or community's identity. To encompass market and non-market concepts of value, the conventional economic concept of market value should be placed in a social and environmental context.

**Past, present and future value**

According to Small and Sheehan (2008) some communities consider land, its ownership and transfer of ownership to be part of a spiritual or cultural matrix of rights, obligations and relationships. The land might be regarded as collectively owned by all members of the community – past, present and future. The living are mere custodians. In this situation, value is likely to represent something more than the present value of future economic benefits and so sale at that price would not only undervalue the land but also disenfranchize future members of the community. Essentially, while it may be possible to estimate the economic rent that might be charged for a fixed duration of occupation of the community land (or part thereof), it is not possible to reliably estimate the capital value of its outright and permanent sale.

This context might be cultural, religious and spiritual or may refer to the ecological or amenity value that tenure rights confer. Herein lies a difficult task, how to identify and quantify non-market values. For example, a valuer may be asked to estimate the "value" of trees or other natural features that hold spiritual significance to a community. The features may possess market value in terms of their fruit-bearing or material-providing capacity but their religious and cultural non-market value to the local community may be much greater.

Developed economies with established land and property markets may set standard formulae for quantifying compensation, in respect of non-market value for expropriated tenure rights. This may be acceptable because tenure rights are capable of being unambiguously identified.

**Trying to quantify non-market value**

In the United Kingdom of Great Britain and Northern Ireland, in addition to the payment of compensation, owners and occupiers of a "dwelling" may claim a further payment, known as a home loss payment. The displacement must be the result of an expropriation of tenure rights and the dwelling needs to have been occupied as a main residence for one year before the expropriation. The amount payable for a freeholder or a leaseholder of a lease exceeding three years is 10 percent of the market value of the interest acquired, subject to a maximum of £53 000 and a minimum of £5300 from 1 October 2015. Care should be taken to ensure that a single payment adequately reflects loss of livelihood, particularly in the case of small farms, subsistence agriculture and other marginal economic activities. These are difficult to replace because of a lack of suitable alternative land. Insufficient payment will not sustain the family for long, forcing the affected party to seek an alternative livelihood, often in the unskilled labour market.

However, it is more challenging when tenure rights are customary and informal. Benefits associated with such tenure rights are often felt beyond the individuals and communities holding those rights. For example, benefits associated with forests (timber and non-timber products, climate regulation, carbon sequestration, watershed services, soil stabilization/erosion control, air quality, biodiversity, recreation and tourism, etc.) are more in the nature of public services rather than personal benefits. In addition, such rights are often legally ambiguous. For example, carbon rights are not well defined in many countries (Felicani-Robles, 2012). The same applies to many of the other services where the title holders may or may not be recognized nor deemed to be the beneficial "owner".

As more attempts are made to recognize and quantify the non-market value of customary, communal and informal tenure rights, the profession can gradually improve the basis on which these valuations are undertaken.

The difficulty in quantifying non-market value is exacerbated by the economic tenet of conventional valuation models, which is encapsulated by the concept of "discounting" future values – valuing contemporary benefits more highly than those in the future. Owners of tenure rights may have time horizons that are far longer than those of economic decision-makers. The economic concept of market value, therefore, fails to adequately account for environmental and social value. It is, essentially, an example of market failure. Many countries recognize this and have implemented environmental and land use regulations as a means of attempting to account for non-market value.

It is important to agree the method for determining both market and non-market value with all participants.

## Valuation assumptions

In addition to agreeing the appropriate basis on which to value tenure rights, it may also be necessary to agree certain assumptions.

| TYPICAL VALUATION ASSUMPTIONS | |
|---|---|
| | Title …… |
| | Occupancy, e.g. vacant, subject to a lease …… |
| | Use, e.g. as an operational entity, or an individual asset for removal …… |
| | Condition of land and buildings, e.g. soil structure and quality, contamination and hazardous substances …… |
| | Availability of services, e.g. electricity, water …… |
| | Planning consent …… |
| | Ownership of plant and machinery …… |
| | Reliability of records provided …… |

A valuation might assume that a property is in good condition, services are operational, there are no deleterious materials, structural defects or hazardous materials present and statutory requirements relating to construction have been met. Land is usually assumed to be capable of development or redevelopment with no abnormal costs, no archaeological remains and no pollution, contamination or risk of flooding. If land is mineral-bearing or suitable for use as a waste management facility, it may be necessary to make an assumption that can be reflected in the valuation.

Often a separate valuation of plant and machinery is required, particularly for industrial properties where they may represent a significant proportion of the tangible assets. Plant and machinery may be valued *in situ* or it may be assumed that it is to be removed (at the expense of the purchaser).

Special assumptions assume facts that differ from those that exist at the valuation date.

| TYPICAL VALUATION ASSUMPTIONS | |
|---|---|
| | A development or refurbishment is finished when in fact it is still under way …… |
| | A property has been leased on specified terms when it is actually vacant (or vice versa) …… |
| | Planning consent has been, or will be, granted for development …… |
| | There is a restricted period in which to sell the property …… |
| | Future revenue projection, perhaps from an agricultural environmental scheme or anticipated trading performance in relation to trade-related properties …… |

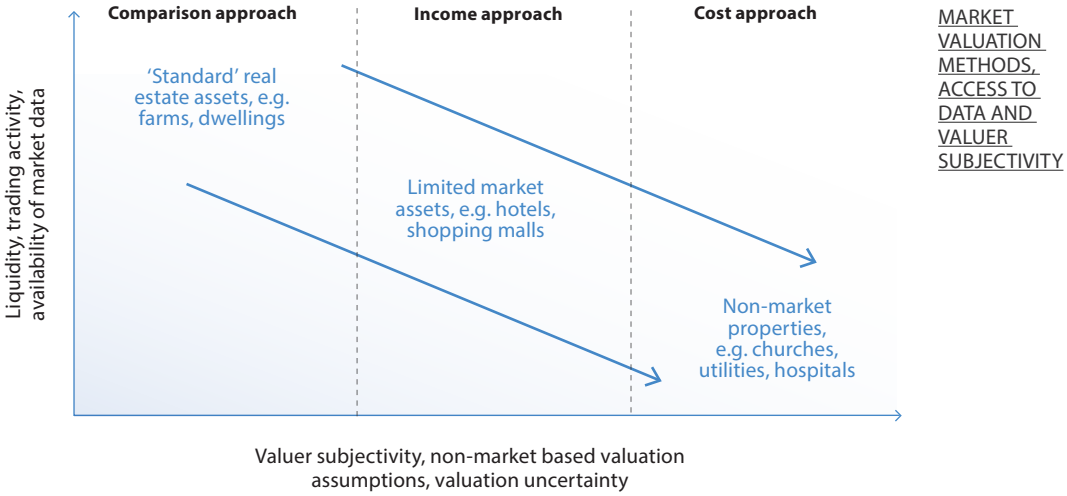
Where an asset has been damaged, special assumptions may include treating it as reinstated, or regarding it as a cleared site with planning permission for the existing use, or redeveloped for a use for which there is a prospect of obtaining planning permission. For example, when valuing a piece of development land for lending purposes, it may be practical to assume that the proposed development is complete. Specific lending criteria would then determine how and when money is released to fund the development.

## Valuation methods

The Guidelines recognize the existence of a wide range of values and encourages their recognition. The key distinction that is made is between market and non-market value. The valuer's skill set has conventionally focused on the estimation of market value but in some cases social and environmental impact assessments can complement market valuations to ensure that people affected are fully informed and, if appropriate, that fair settlements are achieved. These assessments may well call on different skill sets than those fielded by conventional valuers.

### Estimating market value

Whichever method is employed it should reflect the behaviour of market participants. The figure below shows that in active markets, where there is a large quantity of transactions involving properties with similar characteristics, the role of the valuer is essentially to interpret market signals and apply them to the subject property – a comparison approach. With limited availability of market information, market valuation methods are increasingly cost-based. Valuers are required to make more assumptions and this increases valuation uncertainty.



## 1. Comparison approach

The comparison approach to market valuation relies on transaction prices and rents generated by trading activity and transactions to provide the evidence on which to base an estimate of market value. Of course, no two properties are the same so a valuer must adjust for differences in tenure rights, land and property characteristics or transaction date. The approach relies on comprehensive and up-to-date records of trading activity.

### *a) Sales comparison*

Value is estimated by examining the prices of comparable tenure rights that have recently transacted in the market. Valuers collect evidence of transactions and eliminate those not conducted at arm's length (between parent and subsidiary companies for example). Transactions can be sales (which reveal evidence of capital values and yields) or new lettings (which reveal evidence of rental values). Other types of transaction can also be used to provide evidence of market rents. These include renewals of existing leases, rent review settlements and assignments. Evidence can be ranked in terms of its reliability:

- completed transaction, same property, full and accurate verifiable information;
- completed transaction, similar property, most data available and reasonably reliable;
- verifiable information from public sources and media;
- incomplete, unverifiable but agreed transactions of similar properties;
- asking prices.

Indices and other information (for example from a mass valuation data set): during the comparable selection and adjustment process, variations in size of land and property are reconciled by using units of comparison such as price per hectare or rent per square metre. The valuer then estimates the degree of similarity between the property to be valued and comparable sales or lettings, by considering various comparison metrics.

**Comparison metrics include:**

- location: proximity to the property being valued;
- type of tenure rights: degree of similarity in terms of the nature and extent of rights held;
- date of transaction, including market conditions at the time of the sale or letting;
- physical attributes, including current and potential land uses.

Comparable transactions may be ranked or weighted and, depending on the detail of the information available, monetary or percentage adjustments are applied to the sale or rental price of each comparable property. The geographic extent from which comparable transactions can be selected depends on the type of property and the state of the market.

The reliability of the sales comparison method declines when market conditions are volatile or when valuing specialized land and property for which there is little

market evidence. Yet it may be feasible to use broad value determinants such as land quality, availability of infrastructure, accessibility, and building size, type, age and quality.

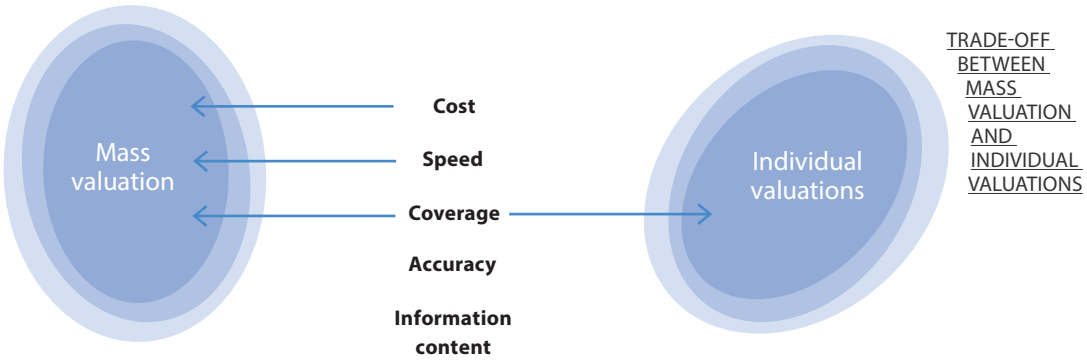
### *b) Mass valuation*

Large numbers of land and property assets may be valued quickly using mathematical models that are typically based upon analysis of comparable sales, to infer statistical relationships between value and determinants of value. The method, known as mass valuation or mass appraisal, is often used to assess value for tax purposes.

Mass valuation offers the potential for fast, low-cost valuations but comprehensive data sets are needed to build statistical valuation models, together with sufficient resources and capacity, both in valuation and statistical analysis. It is essential to identify and collect accurate and timely information on determinants of value and check for any errors and omissions in the data. An appropriate statistical model must be selected and tested.

For example, relatively homogeneous land and property may be grouped together, usually on the basis of location and land use. Based on an analysis of comparable sales evidence, a value per parcel or unit area can be derived and then applied using a mass appraisal model to value all properties in a group. Values of heterogeneous properties can be estimated using more detailed individual analysis.

There is a trade-off between fast, cost-effective mass valuation and nuanced, information-rich individual valuations. Individual valuations are able to incorporate richer data than mass valuations; an inspection may reveal value significant characteristics or the valuer may follow up on enquiries to elicit details that might otherwise be overlooked. A valuer's knowledge and experience is brought to bear on the valuation task.




Many markets are imperfect and it can be difficult to obtain sufficient price information to adequately calibrate a mass valuation model. Instead, tax assessments can be based on key value determinants such as land parcel size, building age, floor area or number of storeys. These act as proxies for value and information on these attributes may be more readily available than price information, particularly in emerging economies. Over time, as market information improves in terms of coverage, accessibility and reliability, prices can be used instead.

## 2. Income approach

### *a) Investment method*

Land and property can be held as investments where the holder of tenure rights passes some of those rights to another party in return for regular payments. The most common arrangement is where an owner leases occupation rights to a tenant. The tenant pays rent to the owner and the level of rent is determined by the supply of and demand for that type of property in the occupier market.

To the owner, rent represents the income return on the investment and the value of the property may be determined by capitalizing the rent at a suitable discount rate. This rate is usually derived from analysis of recent transactions involving comparable properties.

The cash flows of some income-producing properties can be complex, a phased development project or a farm with multiple tenants let on different lease arrangements for example. The cash flow may consist of forecast net rental income over a specified period plus a reversion or resale value. Estimates of the forecast period, net rent, reversionary value and discount rate will be required and should be based on an analysis of market activity wherever possible. For example, in some markets, gross rent (before any deductions for outgoings) is used as a unit of comparison, whereas in other markets net rent is used. The valuer must clearly define the basis of comparison.

Specialist properties require detailed research and knowledge of specific markets. For example, forest investments are mostly long-term, with little if any financial return until cropping, which may be decades in the future. The valuation calculation therefore requires detailed forecasting of future wood-flows, costs and cash-flows and the accuracy of the valuation will be extremely sensitive to the discount rates adopted. FAO's guide on forest valuation, although predating the Guidelines, provides some relevant guidance in this specialist field.

Investors are risk averse and this must be reflected in the valuation. Risks that relate to income can be handled by making adjustments to the cash flow. Risks that relate to the security of the land and property as an investment should be handled by making adjustments to the discount rate – the higher the perceived risk, the higher the discount rate. In emerging markets there may be additional risks resulting from: high inflation and other macroeconomic volatility; capital and other regulatory controls; political changes, war, civil unrest; poorly defined or enforced contracts; lax accounting controls; and corruption.

**Estimating market and non-market value**

A rural community obtains tangible benefits from exercising legitimate individual and communal rights over their land, including the right to fish, raise livestock, grow and harvest crops, collect wild foods, fuel wood, timber and thatching grass. These rights of access, withdrawal and exclusion allow collection of products needed for subsistence and livelihood, and often generate additional income by selling surplus products to the market. Rights that generate sales of tangible products can be valued using the comparison approach and rights that generate regular flows of income can be valued using the income approach. It may also be possible to estimate the market value of some products that are consumed "internally" within the community. The value of some benefits, though, cannot be estimated using market value approaches. For example, some produce, herbs for example, may be medicinal and not traded in a market, so there is a lack of price evidence. Non-market valuation approaches should be used in these cases and these are considered later.

### *b) Profits method*

Certain types of land and property are inextricably linked to the businesses that operate from them; the special characteristics of the location or the premises are central to the capacity of the business to generate revenue. Such trade-related land and property might be regarded as specialized either because they are purpose built or have some monopoly value due to their legal status or planning consent. Examples include mining rights, hotels, casinos and bars. Other businesses may trade well simply on the basis of their unique location; fisheries, safari parks and fuel stations for instance.

Specialized trade-related land and property can be valued by capitalizing estimated future trading potential, as opposed to capitalizing estimated rental income. There is a heavy reliance on accounts and other financial information about the business and also reliance on expertise to value the goodwill element of the business, such as advance bookings. Personal property may need to be valued in conjunction with real property and a special assumption would be required to reflect this.

## 3. Cost approach

The comparison and income approaches to estimating market value are predicated on the availability of market price information. For certain types of land and property, market trading is sparse or non-existent. If there is no existing market for the tenure rights then it may be possible to "create" one through the use of an auction or tender process. This approach may be appropriate in the case of large-scale land acquisitions or the sale of unusual rights such as airwaves for mobile phone networks. If this is not possible then a cost approach may be appropriate.

### *a) Replacement cost*

The replacement cost approach is used to value specialized properties that rarely, if ever, trade on the open market and therefore there is little or no evidence of comparable market prices on which to base value estimates. This method should be regarded as a last resort because replacement cost is a very blunt indicator of market value.

Some properties are specialized because their use requires them to be constructed in a particular way. Examples include: production-specific manufacturing plants such as chemical works and oil refineries; public administration facilities such as prisons, schools and colleges, hospitals, town halls, art galleries and court facilities; and transport infrastructure such as airports and railway buildings. Alternatively, the property might be specialized by virtue of its size or location, such as a large research and development facility in a remote location – ideal for a company's particular requirement but with little or no demand in the open market.

The method has application in the private sector for valuing specialized property for accounts purposes. It is also used to estimate building reinstatement costs for insurance purposes. In the public sector the method is used to value certain types of specialized property for tax and expropriation purposes.

**Using replacement cost for expropriation**

A large area of land is to be expropriated and is likely to have a significant impact on the local rural community, necessitating replacement of some of their communal land and property on account of partial or complete relocation. The properties are typically structures in a village that have to be abandoned and then either condemned or dismantled and reassembled at another location. They might include schools, medical centres, meeting halls and religious buildings. The loss of land and property should be compensated for and their value should be estimated using the replacement cost method.

There are two parts to a replacement cost valuation, a valuation of the land in its unimproved state and a valuation of the improvements to the land. The land is usually valued using the sales comparison method. The improvements are valued by estimating the cost of constructing a new replacement, and then applying a depreciation allowance to reflect any deterioration and obsolescence inherent in the existing property.

In an insurance valuation the site is often assumed to continue in existence despite whatever disaster may have affected the buildings. Consequently it does not include a valuation of the land. Furthermore, if the insurance policy provides for a replacement "new" property (a "new-for-old" policy as it is known) then no depreciation allowance is applied.

### *b) Development value*

Market value must reflect highest and best use and, if land is not being used to its full potential, this means estimating its redevelopment value. Obtaining comparable evidence of development land values can be very difficult; each site is different in terms of size, condition, potential use, permitted density of development, restrictions and so on, making adjustments to a standard value per hectare almost impossible. Instead a cost-based valuation approach, known as the residual method, is used. The method is based on a simple economic concept: the development value of land can be calculated as a surplus or residual remaining after estimated development costs (including finance costs and expected profit to the developer) have been deducted from the estimated value of the completed development.

**Estimating and distributing the development value of informal settlements**

The Mongolian Government is formalizing and redeveloping informal settlements surrounding Ulaanbaatar. A two-stage valuation process has been adopted. First, the development value of the land which is to be distributed as compensation to affected occupiers is estimated. This is achieved through a second valuation – from the occupiers' perspective – that estimates the fair value of each plot within an area of land to be sold to the developer. The valuation comprises the following steps:

a. Recent land sales and construction costs for improvements are analysed to estimate a baseline value per square metre, which is applied to each plot.
b. The area is surveyed, structures identified and distances to key destinations calculated, such as water kiosks, transport corridors, public transport stops, retail clusters, religious sites and parks. Lower values are assigned to plots that are further away from these destinations. Inspections ascertain the duration of ownership, number of residents, age and condition of structures and details of any businesses.
c. Improvements are categorized according to age, size and material used, and their depreciated replacement cost (DRC) is estimated. A maximum DRC is set so that compensation does not exceed the baseline value.
d. Occupiers of plots that include (often informal) commercial activity are offered additional residential space or space in a commercial property in the new development. Each business is categorized according to the complexity of relocation as well as the potential for it to continue within the new development. A premium is applied to businesses in the formal economy and compensation is capped at a maximum of three years of estimated net profits.
e. A multiplier based on duration of ownership is applied, and a further multiplier is applied according to the number of individuals registered as residents at that particular address for a period of more than one year. The multipliers used for years of ownership and numbers of registered individuals are flexible and adjusted so as not to exceed 80 percent of the development land value, leaving room for negotiation.
f. Once all the value components have been estimated, they are added up to arrive at a fair value for the plot.

Valuation approaches such as this do present some challenges. Existing land prices tend to be low and may not equate to a liveable amount of accommodation in a new development, especially when the average number of household members is taken into account. Also, only plot owners are compensated. Assistance, perhaps in the form of social housing provision or a rent-to-own scheme, may therefore be required to help individuals to access formal property.

Formalization of informally occupied land may encourage its expansion, ignoring it may lead to socially unfair compensation, since many occupiers have built considerable and costly improvements on the land. To resolve this, it may be necessary to establish a date beyond which no further improvements to informal land will be compensated.

Poor governance can lead to distrust among affected parties who fear losing what is often their largest store of wealth. Corruption, conflicts of interest and the political motivations of elected officials, together with developers that may over-promise and under-deliver on housing projects, mean that occupiers are reluctant to participate unless considerable guarantees and a premium for risk is provided.

Large-scale redevelopment programmes attract speculators. The public (and often political) nature of projects that have been planned for several years will have raised expectations within the community and this influences the market. Valuers need to be aware of and adjust to the effect of this anticipated development value.

Development value is subject to a high degree of uncertainty even in developed markets. In emerging economies, markets can be volatile, predictable demand timeframes are short and a long list of assumptions accentuate this uncertainty. It is important to ensure, therefore, that valuers' skills and technical capability, along with access to market data, are sufficiently robust.

### Estimating the monetary value for the non-market value of tenure rights

As noted previously, tenure rights are capable of bestowing non-market value on individuals, communities and society as a whole. This value can take the form of social and environmental benefits. Social benefits may be cultural, religious, spiritual, recreational, aesthetic, inspirational, educational, communal or symbolic. Environmental benefits include regulation of climate, flood and disease mitigation, detoxification, carbon sequestration, soil and water quality, as well as supporting biodiversity, nutrient cycling, and primary production. These benefits may be "consumed" by current incumbents or retained as an option for use by future generations. Their "value" to the individuals and communities using them goes beyond monetary value.

There is no need to estimate monetary values for non-market values of social and environmental benefits where the tenure rights are not transferred or there is no significant change in the use of the land. A site of important national heritage may be regarded by citizens as being incapable of having a price assigned to it and as long as the site is protected as part of the country's heritage, there is no reason to attempt to assign a monetary value to it. Equally, individual communities may view their historical territories as part of their inalienable heritage. Some might therefore regard the pricing of such rights as unethical.

While such tenure rights, by definition, do not enter the market, they can be the subject of transactions, and perhaps with increasing frequency. A common reason is the expropriation of land for the purpose of State-enabled infrastructure and large-scale development projects. Another example is a community who wishes to lease out a portion of its land to people from outside the community. In such cases, a decision not to value the land may imply zero value, which in turn will mean that those holding legitimate tenure rights will not receive appropriate compensation for the loss of those rights. To avoid this situation, it is critically important that appropriate methodologies are used and values assessed for compensation purposes in line with the principles and guidance contained within the Voluntary Guidelines. This is very challenging, both professionally and technically, as each case and context will be unique; but it is a matter of particular concern and importance for non-market communities and uses, as is often the case with, for example, indigenous and some traditional communities and with religious and cultural heritage sites. (See FAO Land Tenure Studies 10, *Compulsory acquisition of land and compensation,* for further detail and context.) Several jurisdictions have well established and accepted methodologies for addressing tenure rights that fall into these categories, including for example, in New Zealand, the Waitangi Tribunal and, in the United Kingdom, provisions under the compensation code dealing with non-market assets such as religious land and buildings, etc.

A "Community Land and Natural Resource Valuation Activity" can provide a quick grasp of the implicit value of common land to a local community (Knight 2015). Facilitators ask members of the community to:

a. list all the ways they use their land;
b. list the main resources they gather from land;
c. place a market price on each resource;
d. determine composition of a "typical family";
e. determine how much a typical family would have to spend to replace the quantity of each resource used on a weekly, monthly and annual basis.

A "standard basket" of 6–10 goods is then calculated to arrive at the annual "replacement cost" for a typical family, which is then multiplied by a number of families in the community.

Facilitators then discuss non-market activities and benefits such as ceremonies, celebrations and cultural activities that take place on the community's land, even though they cannot be valued on the market. This can be followed by additional questions relating to the willingness to pay for retaining non-market assets.

This activity provides local communities with an appreciation of the value of resources and non-market activities. This can make them more assertive partners in negotiations and easier to collaborate and partner with.

If a transaction is going to take place, either through negotiation or expropriation, and no replacement can be provided other than in monetary terms, it is clearly preferable to assess the monetary value as accurately as possible. Nevertheless, placing a value on non-market assets is a challenging and often highly subjective task. The principal difficulty is not knowing whether a valuation is "right" – there is no comparable evidence to draw upon. The act of valuing non-market land and property may establish benchmarks but these are likely to be localized and heterogeneous.

Methods of estimating non-market value attempt to monetize social and environmental attributes of land and property that holders of tenure rights value. They are based on social and environmental cost-benefit and impact assessment models and, as such, the methods do not fall directly within the expertise of professional valuers. However, the objective is to combine conventional market valuation methods with non-market methods in order to arrive at a fairer estimation of the value of tenure rights.

As a starting point, when estimating non-market value, valuers should seek to compare like with like, except in this context they must realize that money is not the typical means of exchange.

Valuers need to display broad and deep vision, and exercise balanced judgement when assessing the lives, places and values under consideration. This requires the valuers to be skilled in tackling complex as well as complicated tasks, and the inter-relationship of all kinds of relevant facts and values.

A key task is gathering evidence on which to base an estimation of non-market value. Social and environmental modelling approaches often ask participants to state their willingness to pay for a non-market tenure right or willingness to accept compensation for the loss of that right. For instance for the commons, the concept of replacement value has been advocated, on the basis of estimating how much it would cost community members if they could no longer use the commons for grazing, felling trees, non-wood forest products such as fruit and medicine plants etc.

**How to quantify non-market value?**

Anderson (2006) questions whether adequate "value" is assigned to the land's ability to provide holders of customary tenure rights with food, shelter and livelihood as well as less tangible returns of social cohesion and cultural reproduction, and suggests that the equivalent values of food and shelter could be obtained by comparison with existing market prices. This might help estimate a fairer opportunity cost of the land. There will also be ancillary goods and services and future value to take into consideration too.

Knight (2015) similarly suggests that, in order to estimate rural land value, the total annual replacement cost of a standard basket of goods is estimated for a typical family and this cost can be multiplied by the number of families in the community.

The most commonly used techniques for eliciting respondents' stated preferences are in-person interviews and questionnaire surveys. It is important to ensure that participants are making decisions as "citizens" rather than consumers. Questions should be framed to identify society's perception of value, rather than value to an individual. Affluent members of society may be willing to pay more for a non-market asset than those who are less wealthy because they are able to pay more but non-market value should not be judged in terms of ability to pay.

**Methods of estimating non-market value:**

Contingent valuation is a method of eliciting value statements. Rather than inferring prices from observed markets, participants are asked to report their willingness to pay to obtain a tenure right or willingness to accept giving it up. Most contingent valuation methods use dichotomous choices, whether or not you would pay for or relinquish a right at a specified price. Follow-up questions refine the valuation, as new information is added and any strategic responses identified. It is a deliberative and inclusionary process that is more consensual and participation-oriented towards a local community that can help foster mutual trust.

Choice modelling places several alternatives in front of respondents, often including the status quo, and they are asked to select their preferred choice. Respondents are presented with a hypothetical change in the nature or extent of their tenure rights and are asked to state their willingness to pay for or willingness to accept the change. Both contingent valuation and choice modelling do not, however, explicitly consider the preferences of future generations (Carson *et al.,* 2001).

Participatory approaches typically involve small groups to allow deeper questioning. Community members can be asked to maintain diaries of activities, which are then crosschecked with other diaries and interviews. The use of consultation provides an opportunity to gain mutual confidence and respect, a desired element of the participatory valuation process.

A citizens' jury is a small group that deliberates a policy question (Kenyon *et al.,* 2001), allowing participants to learn as they go and make more informed decisions as the process evolves. As the information set changes, participants' values may change. A citizens' jury reveals the benefits and desires behind decisions so, if combined with the quantitative output from say a contingent valuation, this could provide a deliberative, participatory and preference construction approach to valuation.

Estimates of non-market value are unlikely to be precise but what matters is that participants' willingness to make tradeoffs is revealed, which means they value the actual use of non-market tenure rights as well as the option of their potential use.

**Using a numeraire to estimate value**

Consider the way that a local community might value customary rights over forestland. These rights may not be legally recognized; they may be cultural or spiritual, relevant only to specific groups of individuals. They might include fuel wood, grazing, honey/hives, medicines, wild fruits, hunting and timber. If the economy were subsistence rather than cash based then a non-monetary numeraire could be identified. Participants may also be able to attach monetary value to it, for example a milking cow or a bicycle. The rights, including the numeraire, are scored using counters. This enables each right to be converted to numeraire equivalents and, because the monetary value of the numeraire is known, cash equivalents too.

Non-market values, like market values, derive a large part of their value from the future perceived benefits of holding tenure rights. For market value an economic approach is adopted whereby estimated future income is capitalized at a rate that captures the perceived risk associated with that income. Evidence for the choice of discount rate can be obtained from the market.

Choosing an appropriate discount rate can be much more challenging when valuing non-market assets. In the case of social and environmental assets, the time preference may reflect a collective attitude, which is less expedient and takes a longer-term intergenerational view.

**Social discount rates**

In India, the Supreme Court mandated an expert committee to prepare a system of Net Present Value (NPV) payments "…to be used for achieving ecological plans, and for the regeneration of forest and maintenance of ecological balance and ecosystem. The payment of NPV was to be for protection of the environment and not in relation to any proprietary rights" and payable in respect of forest areas when diverted to non-forest use. The concept of NPV used by the Committee referred to "the discounted sum of rupee values of ecosystem goods and services that would flow from a forest over a period of time net of costs incurred". The Committee proposed apportionment of the NPV compensation funds among the stakeholders at different levels:

- local – 100 percent of non-timber forest products, fuel wood and fodder, 50 percent of watershed services, and 45 percent of biodiversity;
- state – 100 percent of ecotourism, 50 percent of watershed services, 90 percent of carbon and 45 percent of biodiversity;
- national – 10 percent of biodiversity, and 10 percent of carbon.

A case study in Himachal Pradesh was undertaken with NPV calculated over a 20-year period using a 5 percent social discount rate.

## 4.6 Valuation reporting

The output from the valuation process is determined by the purpose of the valuation. For many public sector valuations – for taxation or expropriation purposes for example – a simple figure might suffice. Indeed, in the case of tax assessment, many thousands of valuations may be required and valuation figures, along with basic land and property details are usually the extent of the output.

In the private sector, valuations are often part of broader advice. A valuation for lending purposes may be accompanied by a risk assessment, and valuations for accounts may include a valuation of a property in its existing use and its potential development value. To this end, a valuation figure is usually incorporated into a report. Being the result of a contractual relationship between valuer and client, the content of a valuation report carries legal liability. Mistakes, errors and omissions can lead to negligence claims and, in some cases, the losses incurred can be substantial.

Given the above, and the importance of a valuation report to many financial and business decisions, many professional valuer associations set out the requirements for valuation reports so that there is consistency of output, and potential for omitting items is minimized. Indeed, indemnifiers of valuers will usually insist on adherence to prescribed reporting requirements as a condition of insurance.

As a minimum, the valuation report should identify the client, the purpose and subject of the valuation, the type and use of the property, the legal interest that has been valued and the basis on which the valuation was conducted. The dates of inspection, valuation and report should be recorded together with any assumptions (relating to title, condition of buildings, planning, contamination and hazardous substances, environmental matters and sustainability for example), conditions (such as the handling of taxation, expenses, transaction costs, goodwill, fixtures and fittings), reservations, special instructions and departures. The status of the valuer and disclosure of any previous involvement, extent of investigations and nature and source of information relied upon should also be included. The valuation amount (and the currency in which it is expressed) should be reported with the following:

- a statement of the approach used;
- consent to or restrictions on publication;
- any limits or exclusion of liability to parties other than the client;
- confirmation that the valuation was undertaken in accordance with appropriate national valuation standards. With reference to the Guidelines, these should be in accordance with appropriate international valuation standards;
- details of the basis on which the fee will be calculated;
- the complaints handling procedure or reference thereto;
- the signature of the valuer.

When reporting the value of a portfolio of properties, if the value of the portfolio as a whole is suspected to be different from the sum of individual property values, this should be mentioned in the report. Also, negative values must be reported separately.

The IVSC states that a valuation report must unambiguously communicate the valuation to the commissioning party and other intended users by setting out a clear and accurate description of the scope of the assignment, the purpose of the valuation, disclosing assumptions and special assumptions, material uncertainty and limiting conditions (IVSC, 2013). The report should include reference to:

- identification and status of the valuer;
- identification of the client and any other intended users;
- purpose of the valuation;
- identification of the asset or liability to be valued;
- basis of value;
- valuation date;
- extent of investigation;
- nature and source of information relied upon;
- assumptions and special assumptions;
- restrictions on use, distribution and publication;
- confirmation that the assignment has been undertaken in accordance with the IVS;
- valuation approach and reasoning;
- amount;
- date of report.

A valuation report can take several forms; prescribed formats from say mortgage lenders, internal memoranda, or full written reports. Some reports are likely to be more detailed than others. A detailed report might include a schedule of comparable evidence and an accompanying analysis of that evidence. There may be a commentary on current market conditions, trading activity and future development proposals. Some clients require fully annotated valuation calculations, others are really only interested in the final valuation figure.

The nature and extent of these elements of a valuation report should be agreed before the valuation is undertaken. The calculations that underpin a valuation are likely to be computer files, handwritten "working notes", notes of telephone calls, copies of sales particulars and so on. These should be retained but need not form part of the report or be shared with the client. Valuation standards should set out a minimum content for valuation reports and valuers should be able to produce an audit trail of their decision making process if the need arises.

Several countries have very detailed sets of national valuation standards that are publicly available: Australia, the Netherlands, the United States and the United Kingdom, for example. They tend to relate to valuation work in developed economies with mature markets in tenure rights but nevertheless they offer a useful resource for countries that are considering drafting their own standards.

## 4.7 Summary

- ✓ Valuation should be placed in the context of land policy. It is advisable to have the representation of a valuer at senior government level.
- ✓ Inspections and investigations are a fundamental part of the valuation process and should be undertaken in a logical manner and properly documented. Physical inspection is usual, but collection and analysis of timely, comprehensive and detailed information on land and improvements (ownership, use and so on), transaction details and the wider market context (economic activity, legislation and planning regulation) is essential.
- ✓ Bases of value and valuation assumptions must be clearly defined.
- ✓ Whichever method of valuation is employed, it should reflect the behaviour of participants and affected parties.
- ✓ Valuers should recognize, identify and account for non-market value as well as market value. Valuers should be cognisant of the challenges that estimating non-market value pose and devise techniques to address them. In particular these include the long-term and inter-related nature, and the communal and non-financial nature, of benefits that may be derived. Methods of accounting for non-market value are emerging but much more work needs to be done.
- ✓ The valuation report should be relevant to the purpose and conform to the highest professional standards of ethics, reporting and liability.

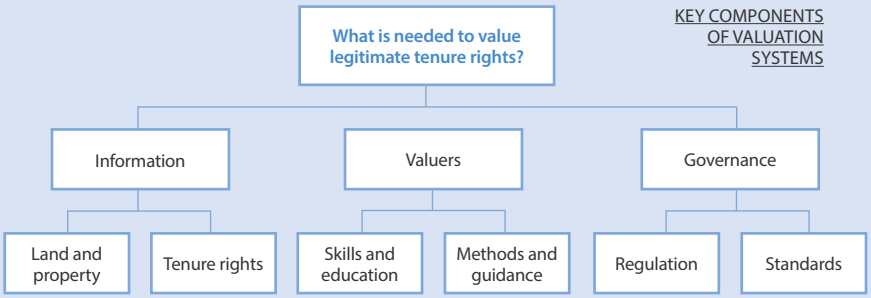
# 5
# What makes an effective valuation system?

# 5. What makes an effective valuation system?

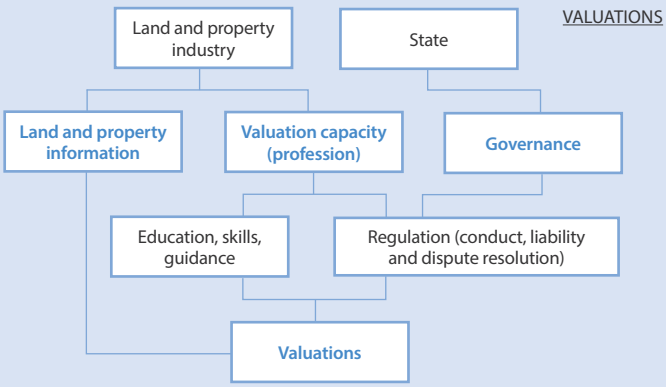
*"States should ensure that appropriate systems are used for the fair and timely valuation of tenure rights for specific purposes, such as operation of markets, security for loans, transactions in tenure rights as a result of investments, expropriation and taxation. (The Guidelines: Section 18.1).*

## 5.1 Key points

- There are three key components of effective valuation systems: first, access to information on the nature and extent of the land and property to be valued, together with comparable evidence and information on the wider market; second, a sufficiently qualified and adequately resourced valuation profession; and third, robust governance of that profession.




- Valuation systems and processes should be capable of managing complex structures of formal and informal tenure rights.
- A valuation system does not succeed in isolation; it needs functioning land and property markets, industry and financial and political support from the State.
- Governance of valuation is essential and encompasses policy, legal and regulatory structure, regulation of valuers, regulation of valuations and education. Continuously monitored and regularly revised international standards govern valuer responsibilities and ethics. Local standards can provide guidance on valuation methods.



## 5.2 Land and property information

*“ States should establish policies and laws to promote the sharing, as appropriate, of spatial and other information on tenure rights (The Guidelines: Section 6.5)*

*“ States and other parties should ensure that information on market transactions and information on market values are transparent and widely publicized, subject to privacy restrictions (The Guidelines: Section 11.4)*

*“ States should provide systems (such as registration, cadastre and licensing systems) to record individual and collective tenure rights in order to improve security of tenure rights, including those held by the state and public sector, private sector, and indigenous peoples and other communities with customary tenure systems; and for the functioning of local societies and of markets. (The Guidelines: Section 17.1)*

*“ States should develop policies and laws that encourage and require transparency in valuing tenure rights. Sale prices and other relevant information should be recorded, analysed and made accessible to provide a basis for accurate and reliable assessments of values. (The Guidelines: Section 18.3)*

Equal and effective access to land and property information is an essential requirement for fair and open negotiations and transactions in relation to tenure rights. This information is therefore of great importance to valuers.

In many countries, trading of tenure rights may be infrequent, mechanisms might not be in place to share transaction information, or it might be difficult to identify the rights that are being traded or the buyers and sellers. This has implications for holders of those rights, particularly if they are vulnerable members of society. Potential purchasers may have power or access to resources (skills and knowledge as well as information) that may not be available to holders of legitimate tenure rights.

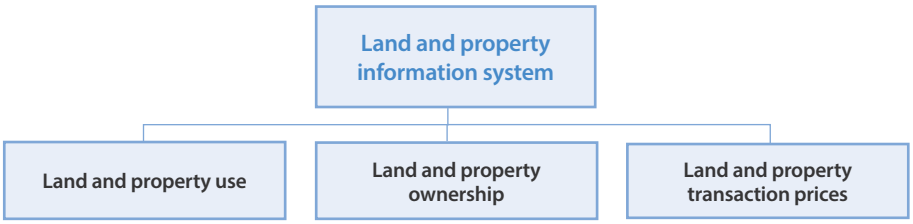
These asymmetric trading positions can lead to the acquisition of tenure rights at prices that are not a true reflection of their market value, let alone their non-market value. If these acquisitions of tenure rights are compulsory – for expropriation purposes perhaps – then this combination of information paucity and power asymmetry can be contentious. Such transactions are therefore to be disregarded as evidence of market value as they do not sufficiently comply with the IVSC definition.

Disputes are particularly evident in locations undergoing change. In rapidly urbanizing locations, on a city fringe perhaps, rural and urban markets interact and pressure to convert less valuable farmland to more valuable urban land intensifies. Without adequate access to market information by all parties, together with a valuation profession capable of providing objective interpretation of that information, it is possible for holders of agricultural tenure rights to be inadequately remunerated when their rights are acquired for development. In circumstances where extensive tracts of land are acquired, this problem is exacerbated.

It is only in transparent markets that rising values are readily observable. If market trading is not visible it is neither possible to monitor price information nor estimate land value. As a result, transaction prices may not fully reflect the highest and best use of the land.

## Information systems

Many tasks related to the administration of land and property benefit enormously from the sharing of parcel-level information on ownership, use and price. If this information is kept up to date and accessible to all, then stakeholders are able make informed decisions about the future use and development of land and property.




COMPONENTS OF A LAND AND PROPERTY INFORMATION SYSTEM

The responsibility for the development and maintenance of a comprehensive land and property information system usually lies with the state. This is because the state often initiates the formation of nationwide systems for recording and registering ownership and price information in support of planning, taxation and other government duties.

In many countries the state has introduced a land and property tax. This motivates the creation of dedicated databases, sometimes referred to as fiscal cadastres, to record location or address information together with ownership, use and value details in relation to individual and communal tenure rights. Such databases can be useful for registration purposes, essentially forming the basis for a multipurpose cadastre or land and property information system. It is vital that, when maintaining a land and property tax base, information is shared between the valuation and taxation department and other land administration departments, including the land registry, planning, surveys and utilities. This ensures that new taxable units are added to the valuation roll and any changes to those already on the list are recorded.

Tenure registration systems and other land and property information systems should be developed, maintained and adequately resourced. It is likely that coordination will be necessary when the different systems are developed and maintained in separate government departments. Common referencing and unique identifiers are essential in these circumstances, particularly with the growing move towards integrated land information systems.

## Information on customary and informal tenure rights

In many countries information on customary and informal tenure rights is not readily available and this makes markets in these rights more risky. Financial investors will place a higher risk-adjusted discount rate on potential revenue and impose more stringent lending criteria, thus devaluing tenure rights. Potential buyers will need

to spend more time and resources on due diligence, either trying to obtain the information they require to make a decision or arrange insurance cover for the risk associated with the transaction.

**Valuers need data**

An electricity supply company wished to construct a high-voltage power line and thermo-electric station. The company must compensate landowners for expropriated land resulting from the project. Valuers were commissioned to estimate the value of the expropriated land. Despite a legal requirement to use records of formal sales as a basis for their valuations, valuers were unable to find sufficient transactions in the locality. After decades of armed conflict in the country, tenure and property rights were unclear and, in some cases, the records were non-existent. Instead, as proxies for land values, valuers based their valuations on the value of timber production, agricultural harvests and built structures.

Maintaining information on unregistered, customary and informal tenure rights is difficult but very helpful when valuing those rights.

**Creating the information base for valuation**

In order to introduce a property tax in Jamaica, field inspections were undertaken to identify owners and occupiers of both registered and unregistered land and "neighbourhood" maps were created using a Geographic Information System (GIS). This system also provides "proof of ownership" records when formal title is being sought. With routine changes of possession or ownership being facilitated through the submission of standard forms, the model operates essentially as a registry for unregistered land. The inclusion of unregistered properties on the Valuation Roll has allowed the Government to employ novel methods to reduce the cost of registering land. For example, ad valorem fees are based on the much lower assessed value (rather than market).

**Opening up access to land and property information**

There has been a substantial increase in online access to land and property information. For example, in 2013 the Netherlands Government took the decision that tax valuations of residential properties must be made public. In practice, what this means is that every residential property owner has access to the assessed value of all residential properties in The Netherlands. This decision was taken to reduce the number of errors in valuations, to ensure that errors can be identified and corrected in a timely way, and to enable taxpayers to compare their tax valuations with others.

## Information on market transactions

A key task of a valuer is to obtain data on transaction prices and, together with details of tenure rights, land and property and wider contextual information, apply this to a valuation. Disclosure and access to transactional data remains difficult in many countries, with secrecy causing a real impediment to data access.

Information relating to all transactions involving transfers of tenure rights should be recorded and made publicly accessible. This should be the case for capital and rental transactions, for state-owned and private land, and for formal and informal markets. States should decide what "land and property" information should be publicly accessible and what "personal" information should remain secret. For example, the address, date and price of sale might be released but the name of the owner may not be.

It can fall to the private sector to initiate data collection and sharing. Large firms may be able to collect their own data but protocols should be agreed to ensure consistency in interpretation and market analysis. Smaller firms often work in specific locations or market sectors and can become valuable sources of specialized and detailed information.

State valuers might have responsibility for land and property tax assessments and for transfer tax administration. Collecting and recording price information is an important part of the information base for these tasks. A state may also deal with land directly – sales and leasing of state-owned land for example – and this is an important source of price information.

High transfer taxes are detrimental to market transparency because they create an incentive to under-declare prices in order to reduce tax liability. Low transaction taxes reduce this incentive and can therefore improve the reliability and accuracy of transaction data recorded by the state. Making transaction data accessible will improve the ability to detect errors and false declarations of price paid. The imposition of a capital gains tax can encourage more accurate reporting of acquisition prices because it encourages the regular and truthful reporting of the value of land and property.

**Collecting information on transfers of land use rights**

In some countries all land is owned by the state and cannot be sold or otherwise transferred. Instead, the state may grant transferable land use rights. When a land use right is transferred, a tax must be paid based on the declared transaction price or whatever price the tax authority determines. It is necessary, therefore, for the tax authority to capture transaction details such as price, date of transaction, land use information, parties involved and amount of transfer tax.

## 5.3 Valuation capacity

*“ To the extent that resources permit, states should ensure that implementing agencies and judicial authorities have the human, physical, financial and other forms of capacity to implement policies and laws in a timely, effective and gender-sensitive manner. Staff at all organizational levels should receive continuous training, and be recruited with due regard to ensuring gender and social equality. (The Guidelines: Section 6.1)*

*“ Relevant professional associations for services related to tenure should develop, publicize and monitor the implementation of high levels of ethical behaviour. Public and private sector parties should adhere to applicable ethical standards, and be subject to disciplinary action in case of violations. Where such associations do not exist, states should ensure an environment conducive to their establishment. (The Guidelines: Section 6.8)*

The Guidelines recognize the complexities associated with the delivery of services related to tenure. Effective land administration requires the establishment of strong institutional frameworks to support cadastral mapping, spatial planning, registration, valuation, taxation and billing and collection functions. These rely upon highly skilled professionals, who in turn, require an enabling environment of academic training, regulated professions and ethical conduct to deliver fair, equitable, transparent and sustainable services.

In many countries, inadequate budgetary resources, inefficient administration and lack of regulation have led to poor and even corrupt service delivery. In many developing countries and countries in transition, government agencies are typified by a lack of qualified staff and low levels of pay, while private sector professionals often operate in poorly regulated environments. The Guidelines encourage states to provide adequate, often significant, resources to ensure that capacity, including valuation capacity, is developed and maintained and to provide a suitable enabling environment for the development of professional associations.

## Valuations in the public sector

Administration of valuations (developing valuation techniques, managing mass appraisals, constructing and maintaining databases) in the public sector might be undertaken by a central valuation agency. This has the advantage of offering a single service to those parts of the government that require valuations for taxation, expropriation and state land leasing. The creation of a single valuation service should reduce duplication of resources, promote data sharing and benefit from economies of scale in terms of data handling. It should also encourage development of skills and knowledge in specialist areas of valuation such as specialized premises, infrastructure, utilities, and plant and machinery.

The extent of a public sector valuation service provision will be a matter to consider in the light of a trade-off between the need for market data and analysis (where the private sector often performs more favourably) and legal, technical and administrative experience (at which the public sector often outperforms).

It may be that the public sector takes the role of facilitator, compiling land use, ownership and transaction data, and the private sector combines this with its market trading knowledge. A public–private partnership of this type can form the basis for the development of a valuation profession that is able to apply its skill set to market data and ensure that statutory valuations are grounded in market evidence.

**Valuers in the public sector working with valuers in the private sector**

A government seeking to implement an *ad valorem* land and property tax may require thousands of valuations. This can be expensive to administer, particularly if the tax policy requires regular revaluations. State valuers may possess the requisite skills to undertake valuations for tax purposes but may lack knowledge of market conditions. The result can be a mechanistic or 'market unaware' approach to valuation and a tax base that is seldom updated to reflect extant market conditions.

A similar set of issues can arise when undertaking valuations for expropriation purposes. Without sufficient understanding of local market conditions (including demand for and supply of land for different uses and the development potential of land) compensation paid to holders of tenure rights may be based on cost-replacement of existing use rather than fair value.

## Valuations in the private sector

In the private sector there is growing demand for valuations from individuals, groups and corporations not only in response to statutory valuations, for example appealing tax assessments or contesting compensation for expropriated tenure rights, but also valuations for loan security and valuations of land and property (see Chapter 3). In many countries there is insufficient capacity for these valuations

to be undertaken using local resources. Instead, overseas valuers may undertake valuations, particularly in the case of land and property operated by large multinational businesses. It is important to be mindful of potential information and knowledge asymmetry when negotiating with local holders of tenure rights.

**Private sector valuation provision**

In China there are three tiers of valuation operations (Hemphill *et al.,* 2014). International firms have a wide range of service provision and well-resourced data gathering and synthesis functions. Large domestic firms with capital and capability undertake appraisals on behalf of state-owned enterprises and large corporations. Small firms deal with the residential sector together with agency and management services.

## Professional valuers' associations

The establishment of an association that represents valuers can be a key facilitator in ensuring that a sufficient number of valuers exist to meet demand. A valuers' association can:

- Oversee education and skills development, including preparation and update of guidance on valuation processes and methods.
- Regulate the conduct of valuers, including ethical considerations and the provision of liability assurance for valuation advice through indemnity insurance.
- Provide an affordable and accessible means of dispute resolution.
- Finally, and perhaps most importantly, it will have a governance structure that includes a set of valuation standards to help ensure objectivity of valuations and integrity of valuers.

### Education and skills development

An essential component of an effective valuation system is an educational faculty that can deliver appropriate training and education. It will have a distinct body of knowledge, centred on valuation methods.

**Getting the skill set right**

Experiences in some post-Soviet transition countries provide a note of caution. Despite a strong need for market-based valuations to facilitate the transition from dirigiste economies, valuation professions were created in a non-market environment and valuers were recruited from engineering and land surveying professions. These groups often managed to "capture" the valuation profession and overemphasize technical and legal aspects of valuation at the expense of economic and financial aspects. This was then reflected in education and training curricula and ultimately in valuation methodology.

Valuation curricula will vary according to the political, legal and economic environment in which valuers operate but there are some fundamental areas of

knowledge. These are the economics of land and finance, and the law of property, contract, tort and administration (specifically land use planning and tax).

Usually the suitability of a curriculum is monitored through a process of professional accreditation, so the concurrent development of an education system and professional association is common. Sometimes a valuation profession develops in isolation from market trading and in such cases the profession can become overly technical. Professional representation and training that encompasses both statutory and market valuations, together with strong links to agency, brokerage and transactional responsibilities, can reduce this type of detachment.

Institutions with regulatory functions over the valuation profession should ensure adequate opportunity for its development. It is vital that educational and professional development is adequately resourced and maintained.

To build valuation capacity, it is important for potential valuers to be able to develop skills in property market issues and valuation techniques through professionally accredited training and education, including degree courses, apprenticeships and continuing professional development. Although international valuation bodies can accredit education programmes, there should be sufficient local capacity to train and educate valuers.

Oversight of the content of training and education curricula is essential and is unlikely to be satisfactorily achieved by the state alone. A professional body is best placed to provide thought leadership in respect of educational requirements for entry into the profession, the skills and training that are required and how they can be provided.

### Regulation of conduct

*“States and non-state actors should endeavour to prevent corruption with regard to tenure rights. States should do so particularly through consultation and participation, rule of law, transparency and accountability. States should adopt and enforce anti-corruption measures including applying checks and balances, limiting the arbitrary use of power, addressing conflicts of interest and adopting clear rules and regulations. States should provide for the administrative and/or judicial review of decisions of implementing agencies. Staff working on the administration of tenure should be held accountable for their actions. They should be provided with the means of conducting their duties effectively. They should be protected against interference in their duties and from retaliation for reporting acts of corruption. (The Guidelines: Section 6.9)*

*“Implementing agencies should make their valuation information and analyses available to the public in accordance with national standards. States should endeavour to prevent corruption in valuation through transparency of information and methodologies, in public resource administration and compensation, and in company accounts and lending. (The Guidelines: Section 18.5)*

Valuer regulation should centre on the creation and adoption of professional codes of conduct and ethics. Governments should support such activity and encourage openness and transparency in the valuation process.

The aim is to build trust in valuer activities by ensuring valuers act with independence, integrity and objectivity, have sufficient knowledge of the relevant tenure rights and land and property assets, and possess appropriate skills and experience to undertake the valuation competently. It also helps valuers withstand external pressures, client influence and the potential for corruption.

Quality assurance and procedural standards are also important. These protect users, so they understand what they are getting, and protect valuers, whose reputation might suffer if users are dissatisfied with their service. Therefore, procedural rules require valuers to explain what is to be done (terms of engagement or service agreement) and what has been done (valuation output). They also facilitate the appeal and review of valuations via tribunals and courts.

If confidence in valuations is to be assured then they should be transparent, coherent and consistent, and they should be undertaken by honest, impartial and competent valuers.

Valuers producing valuations for financial reporting and lending purposes can be subjected to intense client pressure and they should work with regulatory authorities to combat this. In some countries valuers may rely heavily on a small number of very large clients, state-owned enterprises for example. The ability to withstand client influence and pressure will need to be particularly robust in these circumstances.

The dangers of ineffective valuer regulation:

- Increased levels of valuation variance, where valuers are unable to agree with one another to an acceptable degree
- Valuation inaccuracy, where valuations are unacceptably different from market prices
- Susceptibility to client influence, perhaps as a result of over-reliance on a single client's fee income for example
- Conflicts of interest, where the impartial representation of a stakeholder's interests may be open to question
- Valuation negligence and, most seriously
- Fraud and corruption

If valuers cannot be held liable for their errors, omissions and other mistakes then there is little incentive for them to avoid malpractice that might benefit them in some way. Some countries impose obligatory insurance on valuers which engages insurance companies in assuring quality control across the profession. The existence and use of professional indemnity insurance is important.

### Dispute resolution

*"States may consider introducing specialized tribunals or bodies that deal solely with disputes over tenure rights, and creating expert positions within the judicial authorities to deal with technical matters. States may also consider special tribunals to deal with disputes over regulated spatial planning, surveys and valuation. (The Guidelines: Section 21.2)*

*"States should strengthen and develop culturally acceptable forms of dispute resolution, especially at the local level. Where customary or other established forms of dispute settlement exist they should provide for fair, reliable, accessible and non-discriminatory ways of promptly resolving disputes over tenure rights. (The Guidelines: Section 21.3)*

Market and non-market values are socially created so dispute resolution should include representation from valuers who are well versed in the local context. They should also be transparent and impartial in their decision-making processes.

This is particularly so in cases of valuation for expropriation, as this can involve parties that are very different in terms of size, power and access to resources. When it comes to non-market values, similar principles apply according to the relevant definition.

While the courts must remain the final arbiters in valuation disputes, deliberative and inclusionary processes (DIPs) of the nature described above should be adopted prior to any court engagement, and their results made available to the courts. Successful DIPs will be able to determine the valuations, thereby removing that burden from the court system. Some jurisdictions consider that valuation determinations made by tribunals comprising, for example, a professional valuer, a magistrate and an eminent local are to be automatically accepted by the courts unless sufficient evidence of fraud or negligence is presented.

In all such DIPs or more formal independent valuation tribunals, it is essential that the affected parties are able to present evidence that is both transparent and accountable. In cases of expropriation, unless the courts later determine that claims were baseless and vexatious, the cost of expert representation should be considered a legitimate claim for disturbance. Therefore, subject to the laws of the relevant jurisdiction, a preferred order of dispute resolution in cases of expropriation would be:

a. arm's length negotiations between the parties;
b. continued negotiation, with appropriate expertise available to the parties, including mediators if appropriate;
c. DIPs such as value juries (citizens' juries charged with deciding values) or valuation workshops;
d. independent valuation tribunals instead of DIPs, depending on the culture concerned;
e. the court system.

The earlier that values can be agreed upon, the better for all concerned but a decision must never be premature. In cases of tax assessment, the fourth and fifth stages alone will generally suffice. However, a tribunal or court may, at their discretion, direct DIPs to inform them in appropriate circumstances.

## 5.4 Governance

Governance refers to all processes of governing whether undertaken by the state, a market, professional association, community or other social network. The processes might take the form of laws and regulations, codes of practice or accepted norms. The degree to which valuation is self-regulated (by a valuers' association for example) or statutorily regulated, needs to be considered. It may be preferable to impose statutory regulation of valuers either in place of or alongside self-regulation. There are examples of both self-regulating professional associations of valuers and of statutory regulation of valuations and valuers around the world.

Governance essentially takes the form of "rules" by which valuers are expected to conform. It regulates responsibility for incorrect valuations and resolving disputes. Usually these rules are codified into valuation standards that address ethics, the valuation process and valuation applications. It is important that regulation encompasses conduct and ethics as well as competency, objectivity and transparency.

**Valuation governance in a planned economy**

In Viet Nam, the state defines three types of land valuation:

1. A land value bracket, reassessed every five years.
2. Regional land value tables, also reassessed every five years based on the land value bracket and specific local situations. These are used for land taxation, levies, land use fees and fines for administrative violations.
3. Specific land values relating to the land use rights of particular properties.

Depending on the purpose of the valuation, different methods are employed by different valuers. State valuers must use land values that are established by law and interpreted by committees. Recorded transaction prices are often below market value and unreliable as the basis for market values, resulting, in cases of expropriation, for example, in valuations for compensation which tend to be lower than market values. If a land user appeals against a valuation, it may not be possible to change the valuation because the statutory methodology for assessment does not allow for this. Since only the state can request consultancy on land valuation, this puts private sector valuers under double pressure. Pressure: from an administrative perspective as they are subject to state management of business licenses and permits as well as operations, and from an economic perspective, clients of land appraisal companies are mainly state agencies. Resources are required to undertake regular checks and audits of valuers and valuation practice. This ensures compliance with standards and regulates technical competencies expected of the industry. If rules are breached, penalties for non-compliance or fraudulent behaviour will be required. Valuers may need to be registered or licensed by national regulators to ensure objectivity, independence and protection against potential conflicts of interest.

**Self-regulation**

In the United Kingdom of Great Britain and Northern Ireland, the governance model is self-regulation. The RICS (Royal Institution of Chartered Surveyors) Registered Valuer Scheme is an independent monitoring programme for valuers. The scheme ensures consistent application of valuation standards and encourages best practice in agreeing terms of engagement, maintaining inspection notes, details of comparable evidence and other files, as well as producing reports.

In Namibia, the Council for Property Valuers Profession accredits training and education programmes and administers the registration of professional valuers. The Government requires the Council to draw up a code of conduct, ensure that registered valuers comply with it and put in place measures to investigate and discipline improper conduct. The Council is also able to arrange professional liability insurance on behalf of registered valuers.

## Standards

*“ States and other parties should develop and publicize national standards for valuation for governmental, commercial and other purposes. National standards should be consistent with relevant international standards. Training of staff should include methodologies and international standards. (The Guidelines: Section 18.4)*

Standards help achieve a more consistent and reliable interpretation of valuation principles and their application in practice. Developed economies have moved towards a principles based approach to standard setting. In emerging economies, a more detailed rule-based set of standards can be more applicable, particularly where core valuation skills are not widely available. It is important that valuation standards are consistently and rigorously enforced.

**Enforcement of valuation standards**

In some countries valuation standards exist but are not sufficiently enforced. Professional bodies and institutions may be under-resourced both financially and in terms of human resources. As a result of poor enforcement, bogus and unqualified practitioners, masquerading as valuers, take advantage of this situation and this tarnishes the image and credibility of the profession. Also, corruption is very damaging to the valuation profession. It takes many forms including the influence of powerful people on valuations.

Principles and objectives should be codified and a common terminology developed to clearly communicate value and valuation concepts.

Development of and adherence to national standards that align with international standards helps avoid inconsistencies in definitions of value, valuation approaches and methods.

### International standards

International Valuation Standards (IVS) outline the broad principles of valuation. They do this by regulating valuation process rather than methods employed and by promoting the use of consistent definitions, bases of valuation and reporting standards. The IVS Framework describes the context for valuation practice and the bases and approaches applied. The Framework emphasizes that judgement should be exercised objectively and impartially in an environment of transparency when undertaking valuations, and to minimize the influence of subjectivity in the valuation process. IVSC has published four International Professional Standards related to this:

- a competency framework for professional valuers;
- a code of ethical principles for professional valuers;
- establishing and developing a valuation professional organization;
- a guide to the audit process for professional valuers.

The IVSC does stress, however, that the conduct and ethical behaviour of valuers is a matter for national valuer associations that regulate or licence valuers.

If statutory valuations and market valuations are consistent with a framework of national valuation standards, which is, in turn, consistent with international valuation standards, this can provide a solid foundation for good governance of the valuation of tenure rights.

## National standards

Generally speaking there are two types of national standards: technical or method-driven standards, which tend to be prescriptive; and principle-based standards, which place more emphasis on valuer skills and judgment to determine appropriate methods to apply.

Within the framework and principles of International Valuation Standards (IVS), national standards can set out more detailed protocols. The IVS recognize that countries or jurisdictions may have specific legislative or regulatory requirements that must be accommodated within national standards. For example, Mongolia adopted IVS in their entirety and added three chapters at the end to contextualize their application. The Philippines also adopted IVS, adding identifiable paragraphs specific to the Philippines to form the PVS (Philippines Valuation Standards). In the UK, Australia and New Zealand, IVS are embedded in the national valuation standards. This approach has been successful in the accounting world with the adoption of International Financial Reporting Standards in over 140 countries, resulting in a consistent and widely adopted set of accounting standards.

The IVS are drafted by independent experts and placed in the public domain for consultation, and revised accordingly before adoption. The development of national valuation standards should go through a similar process.

National valuation standards might contain information on the relevant codes and requirements that must be adhered to when undertaking certain valuations. These might include protocols agreed with certain client groups such as mortgage lenders, perhaps for example, requiring more detailed risk assessment. Or they might stipulate protocols for valuations for accounting purposes. The more technical and specific the nature of national valuation standards, the more likely they are to need updating in comparison to IVS. If consistency in the valuation process is the main objective, then country specific requirements should be kept to a minimum.

**National valuation standards**

The Royal Institution of Chartered Surveyors (RICS) is the valuation standards setter for the United Kingdom of Great Britain and Northern Ireland. The RICS Valuation Standards regulate process rather than function: what to do rather than how to do it. They promote the use of consistent bases and other definitions and provide a regulatory framework for valuation advice, build confidence in valuations by requiring ethical and transparent approaches, assist clients in understanding what is being valued, the assumptions made and the limitations that apply. Procedurally the standards establish the purpose and subject of the valuation and ensure the valuer has appropriate knowledge and experience, is free of conflict, and has confirmed that appropriate terms and assumptions have been agreed with the client. They also set out the reporting requirements for the valuation.

**Developing national valuation capacity**

Several international institutions have supported initiatives in developing countries to strengthen their professional standards. The United Nations Development Programme (UNDP) is helping the valuation profession in Rwanda to move towards international best practice. USAID, through the International Real Property Foundation (IRPF), was involved in establishing real estate professional bodies, including in the area of valuation, in Eastern Europe (IRPF, 2002). In Africa, the IRPF was involved in capacity building in the real estate profession in Uganda. The World Bank and FAO have been involved in land reform projects in Eastern Europe and Central Asia (ECA) since the early 1990s and the focus of these projects ranges from land administration and land management to property valuation and property taxation. In addition to initiatives funded by international institutions, there have been national and local efforts to establish professional associations and valuation standards.

## 5.5 Summary

- ✓ Tenure registration systems and other land and property information systems should be developed, maintained and adequately resourced. These systems should record ownership, use and value details in relation to individual and communal tenure rights. It is likely that coordination will be necessary when the different systems are developed in separate government departments. Common referencing and unique identifiers are essential in these circumstances.
- ✓ It is important to record information on customary and informal tenure rights as well as formal rights. Valuation systems and processes should be capable of managing complex structures of formal and informal tenure rights.
- ✓ Transaction details for state-owned and private land, for formal and informal tenure rights, and for capital and rental transactions, should be publicly accessible, with appropriate safeguards on personal information. Transaction taxes should be kept low.
- ✓ Valuations should be transparent, coherent and consistent, and be undertaken by honest, impartial and competent valuers.
- ✓ A sufficient number of valuers are required, with requisite education, qualifications, skills and experience. A valuers' association should oversee education and skills development, regulate the conduct of valuers, and provide an affordable and accessible means of dispute resolution.
- ✓ Valuer regulation should centre on the creation and adoption of professional codes of conduct and ethics. Governments should support such activity and encourage openness and transparency in the valuation process.
- ✓ Successful valuation practice requires well-drafted standards that are effectively enforced. International standards should govern valuer responsibilities and ethics, and national standards should operationalize approach and method. All valuation standards should be continuously monitored and revised on a regular basis.

# Conclusion

The Guidelines recognize the importance of natural resources for economic development and food security by promoting secure tenure rights and equitable access to land, fisheries and forests. As legitimate tenure rights become secure, they become valuable, both in a market and a non-market sense.

This Technical Guide highlights the importance of valuing tenure rights in a wide variety of contexts. Valuations are required by businesses in their dealings with tenure rights when investing, developing and using land, fisheries and forests. They are required by individuals looking to secure and improve their homes and livelihoods, and they are required by governments for taxation, spatial planning, calculation of compensation and infrastructure development.

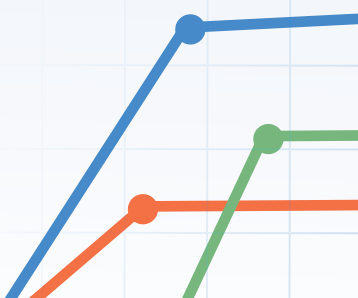
Valuations fill the information gaps in markets that are not always transparent. They inform stakeholders and market participants about the value of their tenure rights and this can be vital in ensuring fairness when dealing with exchanges and acquisitions of these rights. Ready access to price and value information in relation to tenure rights also has a stabilizing influence on this large and sometimes volatile sector of the economy.

Valuations are important for planning: value is a very good measure of the success or failure of land use planning policy. Achieving the right mix of land uses, and the right amount of infrastructure and service provision in the places where it is needed, will stimulate economic activity. Spatial planning that optimizes value generates more revenue from land and property taxation. This creates a virtuous circle as tax revenue is used to improve infrastructure and service provision, leading to further increases in value. Because value is such a useful indicator of land policy success, it can be very helpful for governments to consult with valuers on land policy matters.

It is important to ensure that valuations are undertaken by skilled and impartial practitioners who are regulated by a body or association. Tenure rights and associated land and property are in a constant state of flux; economic activity, political involvement and changing social and environmental needs mean that a profession tasked with valuing tenure rights needs to continuously update guidance, standards and governance procedures.

To conclude, valuations are an important part of land policy formulation. They reveal the value inherent in legitimate tenure rights, form the essential information base for negotiations over transfers of those rights and, by extension, provide a foundation for land and property markets. In short, valuations:

1. ensure the equity of tax assessments and fairness of compensation for expropriation;
2. ensure both market and non-market value are taken into account when buying, selling and leasing formal, customary, communal, and informal tenure rights;
3. provide objective price information to holders of tenure rights in situations where transactions are scarce, such as privatization of state assets or the acquisition of large tracts of land;
4. form a principal component of risk assessment when making loans secured by tenure rights;
5. check the value implications of planning policy and development decisions;
6. help reduce the risk associated with occupying, developing and investment in land and property;
7. provide reassurance to individuals and businesses regarding the fairness of transactions in tenure rights and help reduce disputes.



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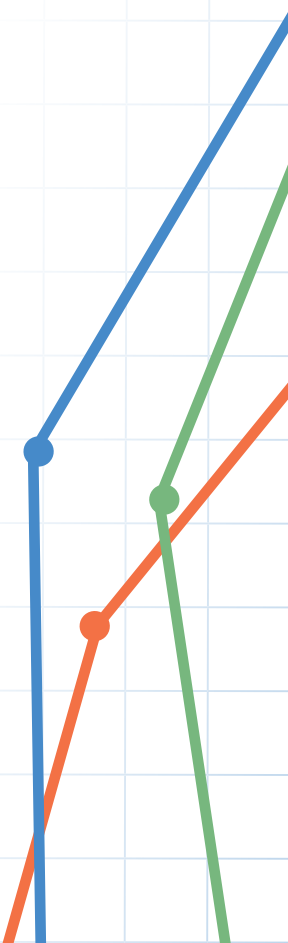


# Glossary

## A

**Ad valorem tax:** a tax where the assessed amount is based on the value of a transaction or of property.

**Asset:** an item of property regarded as having value, owned by a person or company.

**Asset stripping:** the practice of taking over a company in financial difficulty and selling each of its assets separately at a profit without regard for the company's future.

## B

**Betterment tax:** levied on any increase in value attributable to public infrastructure investment or the granting of land use rights.

## C

**Capital gains tax:** accrues to assets that have appreciated in value over time and is payable on sale or transfer.

**Conflict of interest:** Conflicts include a valuer acting for both the buyer and seller of a property in the same transaction, valuing on behalf of a lender while providing advice to the borrower, or valuing a property recently valued for another client. Should such a conflict arise the valuer must decide whether to accept the valuation instruction. If the instruction is accepted the valuer should inform the client about the possibility and nature of the conflict, recommend that independent advice is sought and agree how the conflict is to be managed.

**Cost:** the expense of producing something (a building on a piece of land for example); it is a production-related concept and an important component of many valuations.

**Customary tenure:** The Voluntary Guidelines do not provide a definition of customary tenure rights, however, customary tenure is generally understood to refer to the local rules, institutions and practices governing land, fisheries and forests that have, over time and use, gained social legitimacy and become embedded in the fabric of a society. Although customary rules are not often written down, they may enjoy widespread social sanction and may be generally adhered to by members of a local population. Customary tenure systems are extremely diverse, reflecting different ecosystems, economies, cultures and social relations.

## D

**Deliberative and inclusionary process (DIP):** a set of methodological approaches aimed at creating better informed decisions that are owned by and have the broad consent of all relevant actors and stakeholders. The process includes participatory appraisal, focus groups, Delphi approach, consensus conferences and citizen's juries. DIPs seek to build a process of defining and redefining interests that stakeholders introduce as the collective experience of participation evolves. As participants become more empowered, i.e. more respected and more self-confident, they may become more ready to adjust, to listen, to learn, and to accommodate to a greater consensus.

**Discount rate:** reflects time preference (the preference for current rather than future consumption) and perceived risk.

- **Risk-free discount rate:** rate of return that a person can expect on a completely riskless asset. Most people normally use a government bond rate as a risk-free rate, because it is perceived to have very little, if any risk. Consequently, such a rate can be thought of as representing the time value of money or pure time preference.
- **Social discount rate (SDR):** a rate used to capitalize the annual value of non-market assets in order to try and reflect long-term value to present and future generations. It reflects society's relative valuation of today's well-being versus well-being in the future. It is a discount rate used in computing the value of funds spent on social projects. Choosing an appropriate SDR is crucial for cost–benefit analysis and thus has important

implications for resource allocations. Used in estimating, inter alia, the value of enforcing environmental protection. A higher SDR implies greater risks to the assumption that the benefits will materialize.

# E

**Externality:** side effect from one activity, which has consequences for another activity, but is not reflected in market prices – these effects may be beneficial (positive externalities) or detrimental (negative externalities) e.g. cost to society of pollution for which an entity does not pay.

# H

**Highest and best use:** the use that maximizes potential whilst being possible, permissible and financially feasible.

# I

**Inheritance tax:** charged on the value of property owned at death.

**Income approach:** a valuation approach that is used to value properties held as investments. Such properties generate a rental income and capital value is estimated as a multiple of this income.

**Informal tenure:** may be described as tenure rights that are neither derived from statute nor any customary tenure regime. People living in informal settlements often do not purport to claim legal ownership of the land from either customary tenure systems or from statutes but rather rely on their investment in the land for the time being.

**International Property Measurement Standards:** a standardized and globally applicable method for measuring property (www.ipms.org)

**Investment method:** an application of the income approach applied to properties that are held as investments such as shops, offices and industrial properties. More specialized properties are valued using the profits method (see below).

# M

**Market:** a forum in which buyers and sellers interact. An "open" market is one that has few barriers to entry, information and trading. A market is often defined in terms of its geographical extent, the type of commodity being traded (farmland, dwellings or office space for example), or the characteristics of the buyers and sellers (such as investors, occupiers or developers) that can be defined in very specific terms, for example commercial mining operations in the Pacific islands. Markets vary in terms of access to information and the costs associated with buying and selling. Poor access to information and high transaction costs can constrain market activity. Markets in tenure rights that relate to land, fisheries and forests are different from markets in other tradable commodities, mainly on account of their diversity, geographical distribution, degree of state intervention, and opacity of trading activity. This has a detrimental impact on the level of access to market information, particularly transaction prices.

# N

**Negative values:** these might arise where expenditure exceeds income, for example a leasehold interest where the headrent is higher than the subrent.

# O

**Occupation tax:** a recurrant tax usually assessed with reference to the value of land or the value of land and improvements, payable by occupiers or owners of land and property.

**Ownership tax:** see occupation tax.

# P

**Premium:** a capital sum in lieu of rent payment usually paid at the start of a lease.

**Profit rent:** the difference between the actual rent paid by a tenant and the rent that the tenant

could receive if the tenure rights were sublet at market rent. A profit rent can be notional if the tenant chooses not to sublet, i.e. the financial benefit of paying a rent below market levels is internalized.

**Price:** an exchange-related concept that refers to the amount requested, offered or paid for something. Price relies on the existence of a market in which commodities are exchanged. In a single transaction there might be an asking price advertised by the seller, a bid price offered by the potential buyer and finally, usually after some period of negotiation, an agreed exchange or sale price at which the property is transacted.

**Profits method:** An application of the income approach that is used to value specialized trade-related properties. They are valued by considering rent as surplus payable out of net profit.

**Property:** a word that has many meanings depending on context. It is used in this guide principally to refer to physical land and buildings owned or occupied by an individual or an entity.

# R

**Real estate:** land, infrastructure, buildings and other improvements, minerals and other subterranean natural resources. The legal ownership of minerals is often vested in the State.

**Receipts and expenditure method:** see profits method.

# S

**Sales tax:** see transfer tax.

**Solatium:** a form of compensation for emotional rather than physical or financial harm.

# T

**Transfer tax:** is assessed as a percentage of reported price on transfer of ownership.

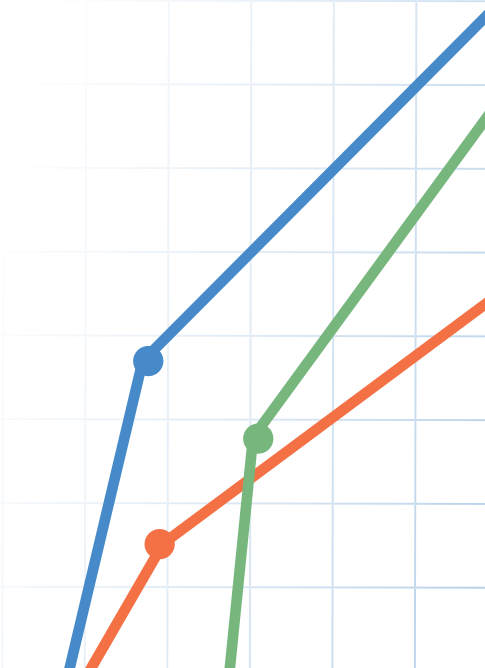
# V

**Valuation:** The process of forming an opinion of value.

- **Contingent valuation:** a method of estimating value based on an assumption that users of the product can accurately reveal their perception of value by stating willingness to pay a certain amount for the product.
- **Mass valuation:** also known as mass appraisal, this refers to the valuation of large numbers of land and property units for taxation purposes, usually conducted using algorithms and statistical models.
- **Participatory valuation:** a method of estimating value of non-market assets that involves key stakeholders discussing and deciding on quanta of value.
- **Roll:** the list of taxable units of land and property held and maintained by a state.
- **Value:** an estimate of price that can be based on various definitions or bases. For example:
  - **Assessed value:** usually a statutorily defined basis of value for tax purposes, sometimes referred to as "cadastral" value.
  - **Break-up value:** the value of individual land and property assets that are sold following the closure of a business or enterprise.
  - **Capital value:** capitalized Rental Value (see below).
  - **Development value:** the value of a site assuming it is developed or redeveloped to its highest and best use.
  - **Fair value:** "…the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties." (IVSC)
  - **Unimproved land value:** Unimproved land value (sometimes referred to as prairie value) is the value of the land with no improvements. Improved land value is the value of land plus improvements to the land. Sometimes the distinction between unimproved and improved land can be difficult to discern.

For example, unimproved land may include certain improvements such as clearing, drainage, etc. that have merged into the land and so are valued with it.

- **Investment value:** "…the value of an asset to the owner or prospective owner for individual investment or operational objectives." (IVSC)
- **Market rent:** "…the estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms, in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." (IVSC)
- **Market value:** synonymous with the concept of exchange value, this is "…the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after property marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." (IVSC)
- **Negative value:** this might arise where expenditure exceeds income – a leasehold interest where the headrent is higher than the subrent, for example.
- **Non-market value:** an intrinsic value that can be attributed to the social and environmental benefits that a real estate may offer.
- **Rental value:** an estimate of annual payment for the holding of tenure rights.
- **Reversionary value:** the value that may be realizable by the holder of tenure rights when subsidiary rights in the same real estate asset end, for example leasehold.
- **Special value:** "…an amount that reflects particular attributes of an asset that are only of value to a special purchaser." (IVSC)
- **Synergistic value:** "…an additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values." (IVSC)



## Governance of tenure **technical guides**

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**FAO.** 2014. *Respecting free, prior and informed consent: practical guidance for governments, companies, NGOs, indigenous peoples and local communities in relation to land acquisition.* Governance of tenure technical guide No. 3. Rome.

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**FAO.** 2017. *Creating a system to record tenure rights and first registration.* Governance of tenure technical guide No. 9. Rome.

**FAO.** 2017. *Improving ways to record tenure rights.* Governance of tenure technical guide No. 10. Rome.

Valuations of tenure rights are required by the State and by the private sector for a wide variety of reasons, often forming and informing the basis of transactions, taxation, compensation and accounting. Value and the valuation process have a direct legal and financial impact on our everyday lives, and yet they are often shrouded in mystery and not clearly understood.

The Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security recognize the complexities of effective land administration associated with the delivery of tenure-related services, specifically referencing the importance of valuation. This guide sheds light on the issues associated with the identification and valuation of tenure rights for different purposes, and provides guidance on how to ensure that valuations are undertaken in a fair, reliable and transparent manner that comply with international norms.


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