The Basis of the Property Tax:
A Case Study Analysis of
New Zealand and South Africa

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Abstract

This report investigates the development of land and property taxation within the jurisdictions of New Zealand and South Africa. The research has sought to address a number of issues surrounding the basis of the property tax in terms of capital improved value, land value or indeed a combination. The choice of New Zealand and South Africa as the main case study countries was largely influenced by the fact that both jurisdictions have a historic usage of different property tax basis.

The report initially covers the main historical developments and provides for an outline of the current legislation affecting the basis of property taxation. The subsequent parts of the report deal with issues pertaining to valuation/appraisal methods, transaction data and the results of a questionnaire aimed at eliciting information of property tax basis. This latter section targeted valuers in South Africa and local government finance officers in New Zealand. The analysis contained in the report highlights and number of interesting aspects with reference the various systems used in both countries.

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Introduction

New Zealand and South Africa represent a somewhat unique opportunity to investigate a number of research questions related to the choice of the most appropriate basis for the property tax. Both countries have traditionally given taxing municipalities the discretion over which basis should be used for determining local rates. This research report begins with an examination of the historic contextual background for each country and then details the underpinning legislation. Valuation methodologies are considered as well as various issues surrounding the availability of transactional data.

From the New Zealand perspective local territorial authorities were each sent a questionnaire to illicit opinions as to the strengths and weaknesses of their choice of system. On the other hand, for South Africa, the questionnaire was sent out to a number of valuers involved in undertaking municipal valuations. The results of both of these questionnaires are presented in the report.

Historical Developments

New Zealand

Currently in New Zealand local authorities have the choice of three alternative systems on which the real property tax or rates may be levied. These systems are (i) the total value of land, buildings and other improvements (capital improved value); (ii) land value only (previously known as unimproved value); and (iii) the annual rental value. However, local authorities have not always enjoyed a choice between these three rating systems.

Provision for the rating and taxation of land and property was made from the earliest days of organized European settlement in New Zealand. The Property Rate Ordinance of 1844 introduced a tax both on property and on income. The Municipal Corporation Ordinance also of 1844 provided for the rating in boroughs.

During the first decade of British colonization in the 1840s, annual value was the most extensively used basis for rating, which was in effect an adoption of the 'English system' of rates. By the mid-1850s all the main rating systems employed today had been adopted in one form or another by various local authorities under the then provincial system of regional government.

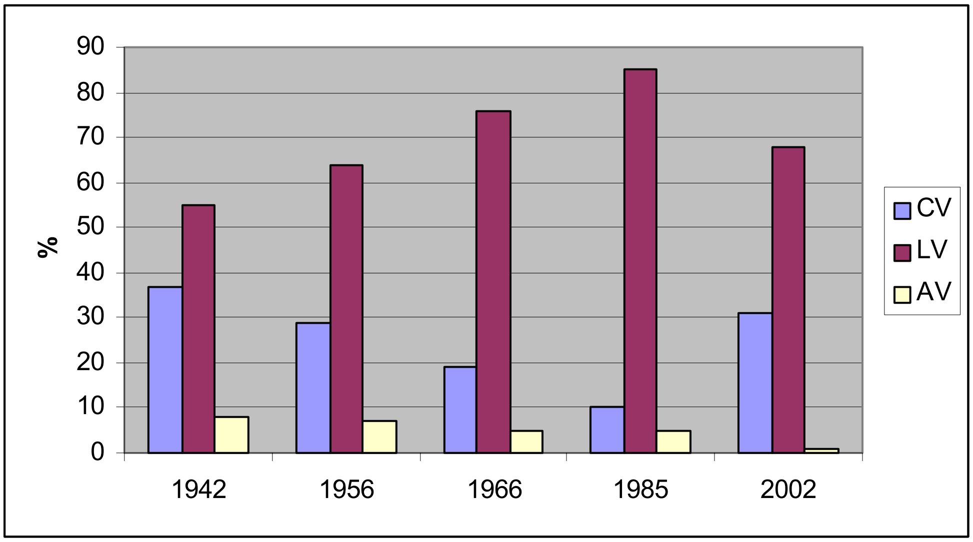
With the abolition of the provincial system in 1876 central government in the same year passed the Rating Act which was designed to achieve a uniform system of rating throughout the country. This act provided for annual value rating only. In just six years in 1882, the tide of opinion had changed and the annual value system was displaced by compulsory capital value rating with only a few exceptions. The effect of this statute was that almost all counties (rural areas) adopted capital value rating with the boroughs (urban areas) adopting an annual value system. The reasons given for the 1882 change were; (i) undeveloped land and land held for speculative purposes had no rental value but a definite market or capital value; (ii) farm improvements usually added more to the annual rental value than to the capital value; and (iii) the introduction of an national property tax based on capital value justified the introduction of a common valuation and tax basis (Dowse and Hargreaves, 1999). The first major step towards the present day position was made in 1893 with the Rating Acts Amendment Act which provided for any local authority to choose by resolution either capital value or annual value as the basis for setting its rates. The unimproved value system interestingly was rejected by central government in 1893, however, its popularity had been on the increase since the depression of the 1880s. The depression engendered a wide-spread dissatisfaction with the existing social set up and was responsible for the greater public interest in ‘left-wing’ political theories. It was against this background that that the works of two liberal thinkers, the English philosopher, John Stuart Mill, and the American writer, Henry George, found ready support among the reformists. The ideas of the two philosophers had special relevance for the field of land taxation. Mill argued that since landowners received a gratuitous reward as the value of their landholdings increased with the progress of the community, there should be a special tax imposed on land to allow the community to share in the values it had created. George reasoned along similar lines that this unearned increment should be the only form of taxation since it did not penalise landowner’s efforts to improve their property.

The early 1890s saw public opinion ready to accept the principle of a tax based on the unimproved value of the land. Then in 1891 the national property tax was modified to give partial exemption to improvements and then the following year full exemption was granted. These developments in general taxation were followed by similar changes in local taxation, and in 1896 the Rating on Unimproved Value Act was passed which made the unimproved value system the third option available to local authorities. However, the local authority could only change to unimproved value if the proposal was first approved by a poll of ratepayers. Similarly, once unimproved value had been adopted as the basis for rating it could only be abandoned with the support of ratepayers.

After 1896, with the advent of three recognised systems of rating available to local authorities, there was a steady move away from annual value and capital value rating to unimproved value rating. The proportion of local authorities using unimproved values increased from 64.2% in 1956 to 76.1% in 1966, while the proportion rating on capital and annual value, respectively, had declined from 29.5% to 19.3% and 6.3% to 4.6%. Clearly over the last fifty years land value based rating has been the dominant system. However, since 1985 there has been a noticeable swing back towards the use of capital improved value. This is more evident within the larger urban areas. Figure 1 illustrates the movement in the usage of the three main tax bases since 1942.

Up until 1976 local authorities could switch from capital values to annual values rating systems without reference to ratepayers, but any change in adopting or abandoning land value required a majority poll of ratepayers. At present local authorities can now change the rating system without recourse to a taxpayer poll however, public consultations would normally take place.

Figure 1: Systems Used by Local Authorities in Percentage Terms



A major conceptual change to rating took place in 1970 when the term 'land value' effectively replaced 'unimproved value' as the basis for rating valuations.
The Local Government (Rating) Act 2002 replaces the Rating Powers Act 1988 and provides the powers to set, assess and collect rates to fund local government activities. It is intended to update and simplify existing rating powers to meet the needs of modern local authorities. Three main purposes of the Act can be identified:

- to provide local authorities with flexible powers to set, assess, and collect rates;
- to ensure rates reflect decisions made in a transparent and consultative manner; and
- to provide for processes and information to ensure ratepayers can identify and understand their liability for rates.

Mechanisms are set out in the Act to allow local authorities to raise revenue from the community generally, specified groups or categories of ratepayers, and those who use or generate the need for particular services or amenities. While the Act updates and simplifies rating legislation, it also contains some significant policy changes. These include:

- Owners will now generally be liable for rates rather than occupiers;
- A single, flexible generic power to levy targeted rates replaces the range of separate rate and charge powers available under the Rating Powers Act;
- Remission and postponement powers are more flexible and extensive than current arrangements, but must be exercised in accordance with policies adopted through the annual plan process.

South Africa

In South Africa property tax refers to a tax called 'rates on property' which is an annual tax on owners of land and presently charged, assessed and collected in terms of provincial legislation in all nine provinces. It has been a source of revenue for urban municipalities in South Africa since 1836.

The statutory imperative to have at least two or three separate values reflected on the valuation roll for each rateable property, dates back to 1903. Table 1 presents a summary of the legislation that mandated separate values and sanctioned the use of different tax bases as a result of these separate values with regards to the former four (i.e. pre-1994) provinces. In each case the sanctioning of separate values pre-dates the allowance for different rating system by a number of years.

Table 1: Legislative Origins of Differential Values and Different Tax Bases

Province	**Year**	**Enabling Legislation (Valuation)**	**Year**	**Enabling Legislation (Rating)**
Cape	1912	Cape Municipal Ordinance	1917	Cape Municipal (Amendment) Ordinance
Orange Free State	1903 1904	Bloemfontein Municipal Ordinance (1903) and the Municipal Corporations Ordinance (1904)	1920	Local Government Further Amendment Ordinance
Natal	1911	Municipal Corporations Law Amendment Ordinance	1924	Boroughs Ordinance
Transvaal	1903	Local Authorities Rating Ordinance	1916	Local Authorities Rating (Amendment) Ordinance

Under the present provincial ordinances still regulating rating throughout South Africa, municipalities themselves still have a choice between at least two of the following three tax bases:

- site rating (ie unimproved land value);
- flat rating (ie capital improved value); or
- composite rating (ie land and improvements, but separately and at different tax rates).

Local choice as regards these three possible tax bases dates back to as early as 1916. For valuation purposes, legislation in all four the former provinces of the pre-1994 South Africa (namely the Cape of Good Hope, Natal, Orange Free State and Transvaal), has dictated a 'separation' of values (i.e. the need for land values and the value of improvements to be reflected separately in a valuation roll) as far back as 1903 as indicated by Table 1.

The merits and demerits of the three tax bases presently being used in South Africa are discussed in some detail in a number of recent studies. (See in this regard, for example, Bahl, 1998; McCluskey and Williams, 1999; McCluskey and Franzsen, 2001; Bahl, 2002; Bell and Bowman, 2002.)

Property tax was an important local tax during the apartheid era. It was almost exclusively levied by former white local authorities and only in some instances in Coloured and Indian townships. It was not levied by former black local authorities, despite the fact that the necessary enabling legislation was, in principle, in place to do so. In the case of the white local authorities generous rebates were generally granted to residential ratepayers, shifting much of the tax burden to commercial and industrial properties. In many instances especially larger local authorities could also afford to set low property tax rates because they were realising substantial profits on the provision of certain trading services (such as the provision of electricity and water). These profits on trading services (in essence implicit excise taxes) allowed many urban councils to 'cross-subsidise' the general rates account. Tax rates were set annually, after the revenue from all other sources were considered - in essence making up the shortfall.

The prominent role of property tax as a source of own revenue has been maintained despite significant reform of the local government sphere in South Africa since 1993. As a matter of fact, its importance as a source of revenue for the recently amalgamated municipalities, established in December 2000, is bound to increase over time for a number of reasons (Franzsen, 2001):

- Municipalities have been saddled with an important developmental role in terms of the Constitution of the Republic of South Africa, Act 108 of 1996 (see sections 152(1) and 153).
- 'Rates on property' (i.e. property tax) is a guaranteed source of revenue for municipalities in terms of the 1996 Constitution (see section 229(1)).
- Although 'surcharges on fees for services' (i.e. what used to be referred to as profits on trading services - see above) are also mentioned as own sources of revenue for municipalities in the Constitution (section 229(1)), the general trend is to become less reliant on surcharges for a variety of reasons (e.g. material changes to the manner in which electricity will be distributed in future).
- Municipalities now cover South Africa's surface area wall-to-wall, in other words all formerly untaxed rural land is in principle included within the jurisdiction of a taxing authority).

There has been marked growth in the total amount raised through the property tax in recent years (*Budget Review*, 2001; *Intergovernmental Fiscal Review*, 2003). For the six metropolitan municipalities the R8.9 billion in property tax represents 22.4% of the total operating income. At R12.5 billion, or 19.4% of total operating income, for all 284 municipalities, property tax is an important source of own revenue for municipalities (*Intergovernmental Fiscal Review*, 2003). If district municipalities are excluded from the equation (as they are prohibited from levying property rates, except in district management areas), property tax as a percentage of own revenue for metropolitan and local municipalities (237 in total) will be even higher.

The Department of Provincial and Local Government (DPLG) held a first exploratory workshop on property tax reform in November 1997. Various draft bills followed which were discussed within DPLG and other government departments (e.g. National Treasury, Department of Public Works, Department of Land Affairs) and at workshops and meetings held with various other stakeholder groups (e.g. organised local government, civics groups, traditional leaders, the valuers' profession and agricultural unions). Eventually the 11th draft of the Local Government: Property Rates Bill was published in the *Government Gazette* on 4 August 2000, inviting public comment. Some aspects were left unresolved in the Bill (e.g. how land under the control of traditional authorities was to be treated). Numerous submissions were received and together with the unresolved policy issues forced DPLG back to the drawing board.

A further draft of the Bill (the 18th), as approved by Cabinet, was tabled in Parliament and published once more in the *Government Gazette* on 14 March 2003. On 7 and 8 April 2003 Parliament's Portfolio Committee for Local Government held a 'closed' workshop with invited stakeholders to thrash out policy issues and practical problems relating to the Bill. As a next important step, public hearings were held at the instance of Parliament's Portfolio Committee for Local Government on 13 and 14 May 2003. Depending on whether outstanding issues are resolved satisfactorily, the Bill may be enacted early in 2004. It is however envisioned that the Bill should become law on 1 July 2004, to coincide with the local government sphere's 2004-2005 financial year. Therefore, the first valuation rolls to be prepared in terms of this legislation will most likely only be implemented on 1 July 2005.

Early drafts of the Property Rates Bill (the last being the 10th) retained the present three options of tax base and the freedom of local choice in this regard.

However, the 11th draft (published in August 2000) provided that a rate levied on property must be an amount in the Rand determined by the municipality on the *improved value of the property*. This major policy shift has been maintained in all the drafts since, and is confirmed by the latest Property Rates Bill published on 14 March 2003 (see clause 10 read with clause 39). The primary reason given for adopting a single system on a national basis is the need for uniformity across the country (*White Paper*, 1998; Bell and Bowman, 2002; Manche, 2003).

Although a move to capital improved value seems to be in line with current international trends (McCluskey and Franzsen, 2001), the implementation of this change will of necessity result in significant shifts in tax incidence. This will be most visible in those municipalities where site rating is presently used (in especially Gauteng, KwaZulu-Natal, Limpopo and Mpumalanga provinces) and, to a lesser extent, in those municipalities where composite rating is used (especially evident in the Free State, KwaZulu-Natal and Western Cape provinces). It is interesting to note that, at the point when transition at local government began in earnest (in 1994), the use of the three rating system was rather evenly spread, i.e. a third each. The distribution within former provinces however indicate a general preference for one or at most two out of the three systems – as indicated in Table 2.

Table 2: Rating Systems Used by Former (pre-1994) Municipalities in 1993/94

Province	Site Rating		Flat Rating		Composite Rating		Total
	No.	%	No.	%	No.	%	
Cape	4	2.4	89	54.0	72	43.6	165
Natal	34	50.7	1	1.5	32	47.8	67
Orange Free State	10	19.6	8	15.7	33	64.7	51
Transvaal	78	88.6	2	2.3	8	9.1	88
Total/Percentage	126	34.0	100	27.0	145	39.1	371

Source: Bell and Bowman, 2002.

The amalgamation of municipalities in 2000 has reduced the number and nature of municipalities significantly. Although the exact numbers for each of the three systems at present are not known (as some of the new municipalities are still in the process of harmonizing their systems), suffice it to say that all three systems are still used in meaningful numbers. Hopefully at least some of these municipalities have been pro-active and have already undertaken preliminary studies regarding the probable shifts in incidence that will result from migrating to a system based on capital improved values (i.e. a flat rating system). In reality only a complete and up to date revaluation on the basis of capital improved values will present an accurate picture of changes in incidence. However, as current valuation rolls must generally reflect improved values, irrespective of the tax based used within a specific municipality, some predictions would be possible which could serve as an indication what kind of measures will have to be implemented as possible transitional mechanisms. For example, the impact of the resultant changes could be countered by phasing-in provisions and/or by using differential rates for different property categories.

When the Local Government: Property Rates Bill, 2003 is eventually enacted, municipalities will only be allowed to levy ‘rates’ on the improved value of property. This will bring to an end a century of ‘value separation’ as the new rating base will require one value only (i.e. the capital improved value of the rateable property).

Basis of Valuation

In this section we provide an analysis of the legislation and relevant case law as it effects the basis of the property tax in both countries. One of the key findings to emerge from this analysis is the similarity in the legislation between the two jurisdictions. However, there are significant differences in terms of the application of the various property tax systems.

New Zealand

The all pervading concept behind the legal definitions contained in the Rating Valuations Act 1998 is market value. This term has been held by the courts as being the basic principle upon which all government rating valuations are to be determined.

The relevant definitions pertaining to rating law are contained in the Rating Valuations Act 1998. This act repealed the Valuation of Land Act 1951 and generally restated the law relating to the valuation of land for rating purposes.

As has already been mentioned in New Zealand local authorities have the choice of one of three property tax bases annual value, capital value and land value. The following are the relevant definitions:

'Annual value', in relation to any rateable property, means the greater of:

a) The rent at which the property would let from year to year, reduced by;

    (i) Twenty per cent in the case of houses, buildings, and other perishable property; and
    (ii) Ten percent in the case of land and other hereditaments: but shall not be less than;

b) Five percent of the capital value of the fee simple of the property:

'Capital value' of land means, subject to sections 20 and 21, the sum that the owner's estate or interest in the land, if unencumbered by any mortgage or other charge, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to require.

'Improvements', in relation to any land, means all work done or material used at any time on or for the benefit of the land by the expenditure of capital or labour by any owner or occupier of the land, so far as the effect of the work done or material used is to increase the value of the land and its benefit is not exhausted at the time of valuation; but does not include;

(a) Work done or material used, whether or not by the owner or occupier of the land, in;

(i) The provision of roads or streets, or in the provision of water, drainage or other amenities in connection with the subdivision of the land for building purposes:
(ii) The draining, excavation, filling, or reclamation of the land, or the making of retaining walls or other related works:
(iii) The grading or levelling of the land or the removal of rocks, stone, sand, or soil:
(iv) The removal or destruction of vegetation, or the effecting of any change in the nature or character of the vegetation:
(v) The alteration of soil fertility or of the structure of the soil:
(vi) The arresting or elimination of erosion or flooding:

(b) Except in the case of land owned or occupied by the Crown or by a statutory public body, work done or material used on or for the benefit of the land by the Crown or any statutory body except to the extent that it has been paid for by way of direct contribution.

'Land' means all land, tenements, and hereditaments, whether corporeal or incorporeal, in New Zealand, and all chattel or other interests in the land, and all trees growing or standing on the land.

'Land value', in relation to any land, and subject to sections 20 and 21, means the sum that the owner's estate or interest in the land, if unencumbered by any mortgage or other charge, might be expected to realise at the time of valuation if;

(a) Offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to impose; and
(b) No improvements had been made on the land:

The 'value of improvements' means the added value which at the date of valuation the improvements give to land.

<u>Capital Value</u>

Under the current definition capital value is taken to represent 'selling value'. The court in *Spencer v The Commonwealth* (1907) 5 CLR 418 stated;

> 'To arrive at the value of the land at that date, we have, as I conceive, to suppose it sold then not by means of a forced sale but by voluntary bargaining between the plaintiff and a purchaser willing to trade but neither of them so anxious to do so that he would overlook any ordinary business consideration.'

Essentially, capital value is not a new or different concept which is only applied to rating valuations, on the contrary, it is an accepted valuation standard implying 'fair market value' which is assessed by reference to a hypothetical sale between a willing seller and a willing buyer (see *Valuer-General v Manning* (1952) NZLR 701).

<u>Consideration of Land Value</u>

The basic definition is relatively simple and similar to capital value with the exception of the last phrase, '…if no improvements had been made on the land.' In essence, land value depends upon the definition of improvements i.e. what can be included as part of the land value and what is excluded. The various legal precedents require the valuer to visualise the land as being vacant and devoid of improvements. In the early case of *Duthie v Valuer-General* (1901) 20 NZLR 585 the learned judge commented that the definition (unimproved value) is quite clear and specific, the improvements must be put completely out of the question.

The Privy Council in *Toohey's Ltd v Valuer-General* (1975) AC 439, an Australian case, had to consider the meaning of unimproved value.

> 'What …[the valuer] … had to consider is what the land would fetch as at the date of the valuation if the improvements had not been made. Words could scarcely be clearer to show that the improvements were to be left entirely out of view. They are to be taken not only as non-existent but as if they never had existed…. What the Act requires is really quite simple: here is a plot of land, assume there is nothing on it by way of improvements, what would it fetch in the market?'

In *Tetzner v Colonial Sugar Refining Co Ltd* (1958) AC 50 the following general principle on the assessment of unimproved value was developed. The land should be valued void of buildings but situated in the community with the amenities and facilities which have grown up around it.

The land value must be assessed separately and independently of the capital value and the value of the improvements. In *Thomas v Valuer-General* (1918) NZLR 164 the Court of Appeal held that the 'unimproved value' must be ascertained without a method of mere subtraction of the value of improvements from the capital value.

A number of valuation principles were ennuciated in *Addington Raceway, Valuer-General and Another v Addington Raceway Ltd* (1969) NZLR 31;

(i) The land must be taken as bare and unimproved at the relevant date as if no improvements had been made on it;
(ii) The unimproved value must be calculated as if held by a single owner and free from any lease or encumbrance;
(iii) The use to which the land is put is immaterial;
(iv) Subdivision potential must be included;
(v) Town planning restrictions and the possibility of their removal must be taken into account;

(vi) The land must be taken as if free from restrictions which do not bind a purchaser, such as restrictive covenants in a lease.

Value of Improvements

While land value and capital value both depend upon the valuer's estimate of realisation, the value of improvements is not so to be determined, but is arrived at by a process of calculation, the result being that the land value plus the value of improvements should never exceed the capital value.

In *Re Wright's Objection* (1959) NZLR 920 it was stated:

> 'The Court has never contemplated that the sum of the unimproved value and the value of improvements could be other than equal to the capital value, and it has always been its practice when considering the unimproved value and the value of improvements, to relate those values to the capital value.'
>
> Later,
>
> 'It is well recognised that a valuer must disregard improvements when assessing the unimproved value of land, and in assessing the capital value of land by reference to what it would realise in the open market, it seems neither necessary nor desirable to attempt to value the improvements, either individually or as a whole. Having made an assessment of the capital and unimproved values, the valuer is entitled to assume that the difference between these values is the added value given to the land by the improvements or, in other words, that it is the value of the improvements.'

South Africa

The basis for valuation for rating purposes in South Africa is market value. This was confirmed by various decisions of the provincial courts. For example, in *SA Breweries Ltd v Kroonstad Municipality* 1913 OPD 34, Maasdorp C.J. in the Orange Free State stated (p 35):

> 'But it was left to the court to decide what was meant by the word "value" and the court decided last year [1912] that "value" meant, in the ordinary signification of the word, "market value".'

It was also emphatically confirmed by the Appellate Division of the Supreme Court (as it was known then) in *Durban Corporation and Another v Lincoln* 1940 AD 36. Watermeyer J.A. (delivering the majority judgement) states the following in this regard (p 41):

> 'It is important to notice that rates may be levied on the whole property, or the land alone, or diversely on the land and the buildings but not on the buildings

> alone… To arrive at the *fair market value* of the property as a whole does not present any insuperable difficulties…' (our emphasis)

This is a confirmation of the *locus classicus* in South Africa as regards 'market value' as basis of the valuation of immovable property, *Pietermaritzburg Corporation v SA Breweries Ltd* 1911 AD 501 (at 516).

<u>Site (i.e. land) Value</u>

The earliest legislative provision for so-called 'site value of land' dates back to 1903. The Transvaal's Local Authorities Rating Amendment Ordinance, 1 of 1916 defined 'site value of land' (in section 4) as follows:

> '"Site value of land" shall mean the capital sum which the land or interest in land might be expected to realise if offered for sale on such reasonable terms and conditions as a bona fide seller would require assuming that the improvements, if any, thereon or appertaining thereto… had not been made. The site value of land shall include any value due to any licence privilege or concession attached to the site for the time being.'

In the same ordinance the 'value of improvements' in relation to land 'shall mean the added value which the improvements give to the land at the date of valuation irrespective of the cost of improvements'.

The relevant part of section 104 of Ordinance 4 of 1913 in the former Orange Free State read as follows:

> '(d) the value of the ground [i.e. land], by which shall be understood the estimated value which such ground would realise if placed in the open market for voluntary public sale.
>
> (e) The value of the buildings by which shall be understood the making of a valuation based on the estimated cost of replacement, at the time of such valuation, due allowance being made for any depreciation existing at the time of such valuation, either in the buildings themselves or in the marketable or rental value thereof.'

In *Durban Corporation and Another v Lincoln* Watermeyer J.A. states the following in regarding valuing land on which improvements have been effected (p 43):

> 'The market value of land, separated from the building that stands upon it, is not an incomprehensible idea… The market value, therefore, of land separated from the building which stands upon it, when determined in the only way it is possible to determine it, is seen to be the equivalent to the market value of the land regarded as a vacant site. [The valuation board] determined the market value of the land, and in the course of doing so, in order to arrive at an attainable result, they regarded the land as a vacant site.'

And (p 45):

> 'In my opinion the only practical and logical view to take is that land regarded as a vacant site has a determinable market value, that the building placed upon it is a physical addition to the land and that thereafter the market value of the property (land and building) may be greater or theoretically it may even be less than the market value of the land alone. The difference – the increase or the decrease – is due to the building, and can be regarded as the value of the benefit or of the burden of the building. It is, of course, not the market value of the building: there is no such thing.'

In *Kleinfontein Estate & Township Co v Benoni Municipality* 1918 TPD 193 Gregorowski J., referring with approval to the Australian case of *Nathan v The Commissioner of Land Tax* (reported in the Second Annual Report of the Commissioner of Land 1911-1912, p 48), states the principle clearly (at p 202):

> 'The definition of "site value" indeed says that the assessment is to be made "assuming that the improvements if any thereon or appertaining thereto had not been made," but this cannot be construed to require the assessment to be made quite irrespective of the profitable use to which experience or history has proved that the property can be put, by certain improvements.'

<u>Value of Improvements</u>

In the case of *SA Breweries Ltd v Kroonstad Municipality* 1913 OPD 34, Maasdorp C.J. in the Orange Free State stated the following (p 36-37):

> 'The Council have gone back upon the procedure they adopted last year, that is to say the again made a valuation of the building according to a very abnormal way of making valuations, namely, by calculating how much brick, mortar and timber there is in the building, and by finding out how much it would cost to put the same bricks and mortar and timber there to-day. Well that is not value; that is the cost – the cost of construction...'

Regarding the manner in which the value of improvements should be established, Watermeyer J.A. decided the following in the *Lincoln* case (p 42):

> 'But when the next step has to be taken and the total market value of the whole property has to be divided into two and allocated in part to the land and in part to the buildings upon the land, a very much more difficult problem arises… A building standing upon a piece of land is like a picture painted upon a piece of canvas; and just as it is impossible to sell the picture apart from the canvas on which it is painted, so it is equally impossible to sell a building apart from the land. It is possible to scrape the paint from the canvas, and it is possible to pull the building down and sell the material, but then the work has been destroyed

> and what is sold is not the building but building material… It is, therefore, idle to attempt to find the market value of the building separated from the land on which it stands, and any valuator who is attempting to do so is pursuing a will of the wisp. The value, therefore, which has to be assigned to buildings… is not market value but value determined in some other way.
>
> If the position of the other component part, the land, be examined, it will be seen that, though there are difficulties with regard to its valuation, they are nothing like so formidable as those connected with the building, and it is not necessary to abandon entirely the idea of market value…'

In summary: In terms of the current provincial legislation in all the new provinces, except KwaZulu-Natal, the value of improvements is arrived at by deducting the site value from the total value, in other words the value of the improvements for rating purposes is indeed a residual value.

However, legislation in the former Cape Ordinance (which applied until the enactment of the 1993 Valuation Ordinance in 1994) also allowed for the value of improvements to be arrived at on the basis of replacement cost minus depreciation. This methodology is indeed still used in certain jurisdictions (e.g. Buffalo City (formerly known as East London) in the Eastern Cape). The 1974 Natal Ordinance (still applicable throughout the province of KwaZulu-Natal) only provides for improvements to be valued on the basis of replacement cost at the date of valuation less depreciation. It also provides that this value must then be added to the value of the land (as if unimproved) to get to a total rateable value. This aggregated value (land value plus the value of improvements) does not necessarily equate to market value (see *Durban Corporation and Another v Lincoln* 1940 AD 36 on 45; Ethekwini Metropolitan Council, 2003).

<u>Definitions From Present Provincial Rating Legislation</u>

(Former) Cape Province

Section 14(1) of the Property Valuation Ordinance of 1993 states that

> 'a valuer shall, for the purposes of this Ordinance, determine –
> (a) the improved value of land, which shall be the amount which such land would have realised if sold on the date of valuation in the open market by a willing seller to a willing buyer;
> (b) the site value of land which shall be the amount arrived at in the same manner as that referred to in paragraph (a) but on the assumption that the improvements, if any, had not been made; and
> (c) the value of improvements, which shall be arrived at by subtracting the site value of the land from the improved value thereof;
>
> provided that where the land or improvements, if any, is or are of such a nature that there is no open market value therefore, the improved value or site value, as the case may be, may be determined therefore-

(i) on the basis of the amount it would cost to replace the improvements in, on or under the land, having regard to the depreciation thereof for any reason, as determined on the date of valuation; or

(ii) in any other suitable manner.'

Section 44 of the Cape Valuation Ordinance 26 of 1944, which was only repealed by the 1993 Ordinance with effect from January 1994, only provided for depreciated replacement cost as method of valuing improvements.

Therefore there are some municipalities in the Eastern Cape, Northern Cape and Western Cape still utilising depreciated replacement costs for buildings, whereas others – under the 1993 Ordinance, arrive at the 'value' of improvements by deducting the land value from the improved value. Since 1912 the value of land has always been the market value as if unimproved.

(Former) Natal

Section 155(5) of the Local Authorities Ordinance 25 of 1974 states:

> 'The value of land shall be the ordinary price which a buyer would have been willing to give and a seller would have been willing to accept if the land to be valued had been brought to a voluntary sale on the fixed date.'

Section 155(6)(a) states:

> 'The value of building shall be the estimated cost of erection at the fixed date, and in determining that value the valuator shall take the estimated cost of erection at the fixed date and from it shall deduct the amount determined by him in respect of depreciation.'

Section 155(7) provides that –

> 'Where, owing to the infrequency of sales or other reasons, the purchase price obtained or obtainable in any locality, or in the case of buildings, the cost of erection, will not, in the opinion of the valuator, serve as a sufficient guide to enable him to arrive at a fair and equitable valuation of any property (whether land or buildings), then the rental and productivity and the possibilities of any such property as an investment shall be considered in establishing the basis of and finally determining the valuation of the property.'

In present day KwaZulu-Natal, the position has remained the same since 1911. Land is valued at market value, whereas buildings and other improvements are valued with reference to the depreciated cost of construction as a general rule.

Ethekwini Metropolitan Council (formerly known as the Durban City Council) makes it clear to ratepayers that adding the (market) value of the land to the depreciated replacement cost of the building(s) on a rateable property does not equate to the market value of the improved property (Ethekwini Metropolitan Council, 2003).

(Former) Orange Free State

In section 106(1) of the Local Government Ordinance 8 of 1962, the following definitions are given:

> 'For the purposes of section 105 [i.e. 'framing' a valuation roll] –
> (a) "value of the rateable property" means the amount which such property without any improvements, would have realised if sold on the date of valuation in the open market by a willing seller to a willing buyer.
> (b) "value of improvements" means the amount obtained by subtracting the amount referred to in paragraph (a) from the amount which the rateable property, including any improvements, would have realised if sold on the date of valuation in the open market by a willing seller to a willing buyer.'

In brief, in the Free State land was always valued (as if unimproved) at market value. For a number of years (since 1913 until the 1962 Ordinance was enacted) buildings were valued at replacement cost minus depreciation, whereas since the enactment of the 1962 Ordinance the value of improvements would again constitute the residual value, arrived at by deducting the value of the land from the improved value of the rateable property.

(Former) Transvaal

Section 9(1) of the Local Authorities Rating Ordinance 11 of 1977 states that –

> '… a valuer shall, for the purposes of this ordinance, determine –
> (a) the improved value of land or the improved value of a right in land which shall be the amount which such land or right in land would have realized if sold on the date of the valuation in the open market by a willing seller to a willing buyer;
> (b) the site value of land or the site value of a right in land which shall be the amount arrived at in the like manner to that referred to in paragraph (a), but on the assumption that the improvements, if any, had not been made; and
> (c) the value of improvements which shall be arrived at by subtracting the site value of the land or the site value of the right in land from the improved value thereof.'

In the provinces of Gauteng, Limpopo, Mpumalanga and part of the Northwest (which formerly constituted part of the Transvaal), land has been valued at market value for the past century, and the value of buildings has always been arrived at by subtracting the 'site value' (i.e. the value of land as if unimproved) from the improved value – i.e. it constitutes the residual value.

Local Government: Property Rates Bill, 2000 (11th draft)

Since the inception of the drafting process of the Local Government: Property Rates Bill in 1998, echoing a principle stated in the *White Paper on Local Government* (published in 1998), Government was adamant about the need to create a simplified, and preferably a uniform rating dispensation for the whole of South Africa.

Despite the policy to establish a uniform system, earlier drafts of the Bill all maintained the various options (i.e. site rating, flat rating and composite rating). For example, the following relevant definitions for rating were contained in the 11th draft of the Bill, published in the *Government Gazette* for public comment in August 2000 as the Local Government: Property Rates Bill, 2000.

The **'General basis of valuation'** is stated as follows in clause 33:

'(1) Subject to section 51(3) of the Sectional Titles Act, 1986, and other provisions of this Act -
- (a) the improved value of property must be determined as an amount equal to what the property would have realised if sold on the date of valuation in the open market by a willing seller to a willing buyer;
- (b) the site value of land must be determined as an amount equal to what the property would have realised if sold on the date of valuation in the open market by a willing seller to a willing buyer but on the assumption that:
  - (i) there are no improvements to the property; and
  - (ii) only the existing improvements may be erected on the property
- (c) the value of improvements must be determined by subtracting the site value of the property from its improved value.'

Clause 33(1)(c) maintained the almost universal principle throughout most of the country (except in KwaZulu-Natal and some jurisdictions in the former Cape of Good Hope) that the value of improvements will be a residual value. In other words, where it still applies, depreciated replacement cost will be abolished as a general method of establishing the value of improvements.

The definition of 'site value' (clause 33(1)(b)) made little sense and would have resulted – if enacted – in the demise of site rating as a matter of course as it, in essence, limited the valuer to 'current use' instead of 'highest and best use' in determining the value of land.

Local Government: Property Rates Bill, 2003(18th draft)

In this latest draft of the Bill to be published in the Government Gazette (in March 2003), the principle of uniformity has at last been extended to the basis of valuation for rating purposes. If this Bill is enacted as it currently reads, site values (and therefore site rating), as well as separate values for building (and therefore the possibility of composite rating) will belong to a century-long past in South Africa.

In clause 1 ‘improved value’ is defined as –

> ‘in relation to a property, means the value of property, including improvements, determined in accordance with this Act.’

Under the heading **‘General basis of valuation’** clause 39 provides as follows:

> ‘(1) Subject to the provisions of this Act, the improved value of property must be the amount the property would have realised if sold on the date of valuation in the open market by a seller to a buyer.
> (2) In determining the value of a property –
> (a) the value of the property as enhanced by any license or privilege relating to the property must be included; and
> (b) the value of any improvement on the property that was erected or is being used in contravention of a condition of title or any legislation, including a provision of a town planning scheme, must be included as if the improvement was erected or is being used lawfully.’

The omission of the word ‘willing’ in front of ‘seller’ and ‘buyer’ respectively in clause 39(1) has rightly been criticised (Zybrands, 2003a). The phrases ‘willing seller’ and ‘willing buyer’ are well entrenched in South African jurisprudence, are well understood by municipal valuers and should therefore be retained in any definition relating to a ‘market value’-based valuation.

‘Mass Valuation’ including Property Banding

A novel development that will be introduced in South Africa is a provision for the use of a ‘mass valuation system or technique’ where ‘the available market related data of any category of rateable property is not sufficient’ for the use of techniques to determine discrete values. Clause 38(3) of the Property Rates Bill, 2003 makes specific mention of a (UK-styled) banding system as one such option. (Property banding may indeed be an option deserving further study in a South African context: see McCluskey, Plimmer and Connellan, 2002).

It is suggested that the use of (a) mass valuation system(s) be strictly regulated. Ideally government should provide guidelines or a framework in terms of when a municipality can use such a system and how it should be applied, so as to avoid a proliferation of possible systems from developing over time.

Valuation Methods Pertaining to Land

When determining the land value there are a number of techniques that can be used based upon sales of undeveloped land. These approaches are largely based around derivatives of the comparables sales method. When open market sales evidence is scarce then the valuer must have resort to adjusting improved sales to extract or deduce the land value component of the property.

There are several accepted valuation methodologies that can be used to determine the land value component of a particular property. The choice of a particular method is largely dependent upon the quality and quantity of transaction evidence available at the time of the valuation. For rating purposes the preferred method used in practice is that of direct comparable sales. However, where comparable sales are not in evidence, income capitalisation and potential rent have been used to determine the value of land (Craythorne, 1997; Gildenhuys, 2002).

As argued by McCluskey and Franzsen (2001) the approach to the value of visible improvements is at best variable. Different approaches can be discerned:

(i) determine the added value of the improvements;
(ii) the unimproved value is determined by deducting the added value of the improvements from the capital improved value or alternatively;
(iii) to apply an upper limit restricting the added value to the replacement cost of the improvements; and
(iv) the value of improvements is determined by deducting the site value from the capital improved value (i.e. market value) of the property.

Feetham J.A. states the following in *Durban Corporation v Lincoln* 1940 AD 36 at 54:

> 'It seems to me clear that neither in the Natal legislation, nor in the legislation of any of the other provinces in the Union, did the mere requirement that the values of land and building should be shown separately introduce any new principle of valuation, or make any difference whatsoever in the principles of valuation to be applied: in all cases property had to be valued either under the express terms of the governing statute, or in accordance with its necessary implications, at its fair market value, taking the condition of the property as it actually existed at the time of the valuation.'

In establishing market value, various methods may be used of which the following have been accepted by the South African courts, namely:

- Comparable sales method, also referred to as 'direct sales comparison' (Jonker, 1984; Gildenhuys, 2002);
- Income capitalisation method (*Kleinfontein Estate & Township Co v Benoni Municipality* 1918 TPD 193 at 198 and 199);
- Rentals (Craythorne, 1997);
- Land residual approach (Gildenhuys, 2002).

Valuation Methods in Respect of Undeveloped Land

The following is a brief review of the main valuation methods that can be used to determine the land value when there are sufficient open market sales.

<u>Direct Site Valuing Method</u>

This particular approach involves the assessment of land value based on the direct comparison of the subject land with other comparable land sales. It does not utilise a unit of comparison but rather takes the land as a block or parcel with individual adjustments for size, location, road frontage, topography etc being made holistically by the valuer. This method is often used when there is a lack of market transactions or where a particular parcel is unique in size, shape or location. The determined value is largely subjective being based upon the experience and knowledge of the valuer. The application of this approach is well suited to valuing rural/residential property on the periphery of urban areas and low cost housing areas within large towns and cities.

A criticism of this approach is that the valuer's opinion of value is highly subjective and not based on other market sales. In consequence, it is more difficult to defend such assessed values which are subject to challenge.

<u>Land Area Method</u>

This is essentially the sales comparison approach where the value of the land is related to its size, current and/or highest and best use and devalued on a unit comparison basis. The unit of comparison can be price per square metre or per hectare/acre. Differences between individual properties can result is widely different prices per unit. Such differences tend to arise from such factors as road frontage, presence of water, sewers and drainage, contours, soil quality and land use zoning. Therefore, it is important to be aware of the uniqueness of each property and be able to identify and measure the factors contributing to its value.

The application of the method to value inner city of Central Business District land is fraught with some difficulty. This is particularly the case when considering the CBD of the main cities where the value of the land is a reflection of its land use zoning, plot ratio and floor space ratio, and where the size of the building that can be erected is directly proportional to the size of the site.

The method is particularly relevant when valuing industrial land where it is evident that the market price of such land does not show excessive price variations in relation to differences between frontage, depth and shape of similar sized sites. The main problem with this methodology is its rather simplistic approach to determining value. It is nonetheless a useful starting point and the basis for developing a more rigorous approach to value.

Frontage Method

This particular method can be applied where land uses, size, shape and contour are fairly consistent within particular categories of land such as residential, commercial and industrial. The approach adopted is to value the land based upon the amount of road frontage and then making adjustments for the depth of the site. Additional adjustments can be made for such factors as corner frontage, slope, view and access. Typical adjustments are made on the basis of percentages such as:

Frontage (m) x Price per metre x Depth % x view % x Slope % = Value

The standard depth table is used to adjust solely for differences in the depth of sites. The determination of the standard depth should recognise that there is some depth at which the use of the site is at maximum efficiency. Generally speaking depth tables should be determined for the local market, however, this is often not possible due to the lack of sufficient sales evidence. Hence the use of standard tables such as the Somers-Cleveland Table and the Standard Jerrett Depth Table.

It is quite clear that no depth table can be expected to cover all categories of land. What matters is the local market conditions and the results of an analysis of the sales. It is essential that no matter what depth table is used the cardinal rule is that the same table used for analysis must be used for the valuation.

Density Method

In applying this method a unit of comparison related to the physical density of development of the land is determined. For residential purposes the unit of comparison could be per dwelling/flat or per habitable room. Therefore, sales prices can be devalued to a unit basis once the number of units has been determined. It is important to recognise whether buyers and sellers in the market base their decisions on potential density levels. If this is the case then adequate market research should reveal permitted density levels which can be applied to recent sales.

The density method has particular applications for the valuation of medium and high density residential land. There is however, limited application within the valuation of industrial and commercial property.

Residual Method

This valuation approach is promulgated on the fact that land value is a residual derived from the capitalised investment value of a hypothetical development according to the lands highest and best use. Essentially, the method relies upon the determination of the gross development value of the land, from which the total costs of the development are deducted, the remaining figure or residual is an estimate of the land value. All construction costs including, finance, developers profit and contingencies need to be reflected.

The residual value computed in this way should ideally be compared against open market sales. As the techniques requires a range of subjective adjustments to the variables it must be applied with a high degree of skill. The sensitivity of variables to slight changes also needs to be considered; for example if construction costs increase by say 10% this may have a reducing effect on the residual land value by more than 10%.

In South Africa the land residual approach has been criticised by Ogilvie-Thompson J.A. in *Estate Marks v Pretoria City Council* 1969 (3) SA 227 (A) at p 248 as 'a complicated exercise involving specialised skills in several spheres', and as a result are not often applied in practice (Gildenhuys, 2002).

Land Valuation Methods in Respect of Improved Land

In the absence of open market transactions it is possible to estimate the land value of a property by analysing improved value sales. These techniques are generally subjective and rely heavily on the skill and experience of the valuer. But in the absence of other evidence they do provide a reasonable approach to determining the land value of a particular property.

<u>Allocation Method</u>

This method relies on the premise that there is a relationship between the value of the land to the total value of the property (i.e. land plus improvements). From the analysis of unimproved land, land development costs and improved sales it is possible to determine for various categories of property a land to total value ratio. A possible ratio based on the analysis of local transactions may be 1:3, representing one part land to 3 parts improvements; or alternatively the land value contributes 25% of the total property value.

This method has a greater potential application for residential property given the greater number of unimproved and improved sales. Its application is more problematic for commercial and industrial property that tends to be sold less frequently.

<u>Abstraction Method</u>

The extraction method implies that the total property value is made up of the value of the land and the depreciated replacement cost of the existing improvements. To apply the method an estimate of the open market value of the property is required and an estimate of the replacement cost of the existing improvements. The value of the improvements is reduced to reflect the condition of the existing improvements. This adjusted improvements value is then deducted from the full value to obtain an estimate of the land value.

It is important to ascertain as accurately as possible the new replacement cost of the improvements and the rate of depreciation to be applied.

Valuation Data

An *ad valorem* property tax as its name suggests is based upon an objective assessment of value of the taxable entity. Therefore, to ensure uniformity and equity in terms of the assessments there is a prerequisite of having 'sufficient' transaction evidence. In addition, transactions are fundamental to the objectivity of the assessed values in terms of being able to substantiate and support values based on comparable evidence. This ability creates a transparent appeal process which in turns provides credibility and ultimately taxpayer understanding and support. It is therefore crucial that no matter the basis of the property tax it is vitally important that there are 'sufficient' data upon which to determine and defend assessed values.

It could be argued that the predominant form of land tenure should give a strong indication as to the basis of the property tax. This in turns relates to the structure and functioning of the real property market in which property rights are traded. The ability to trade in such property rights provides the transaction evidence upon which to determine property values.

In Singapore and Hong Kong the predominant form of tenure is leasehold with the respective governments owing the freehold interests in the land. These property markets are also characterised by significant numbers of apartments and condominiums that are let on the open market. Therefore, it is not surprising that the basis of the property tax in these countries is annual rental value. In most North American and Australian states real property tends to be traded in the capital market and therefore the property tax tends to be based on capital improved values. In Great Britain, commercial property has an active rental market whereas residential property primarily operates in a capital market, therefore, to recognise these important differences commercial property is valued to annual rental value and residential to capital value.

There are several countries that have traditionally or historically adopted site value or unimproved value as the basis of the property tax. Apart from New Zealand and South Africa, these include Kenya, Jamaica, Fiji and certain states in Australia. All of these countries are currently facing the challenge of having sufficient property transaction evidence upon which to continue to adopt land value property tax systems. The problem of the lack of evidence is more acute in the highly developed urban areas and main cities. Whilst outside of these areas there would appear to be sufficient sales to support a land value system.

This section of the report focuses on data issues such as availability, quantity and quality with respect to New Zealand and South Africa.

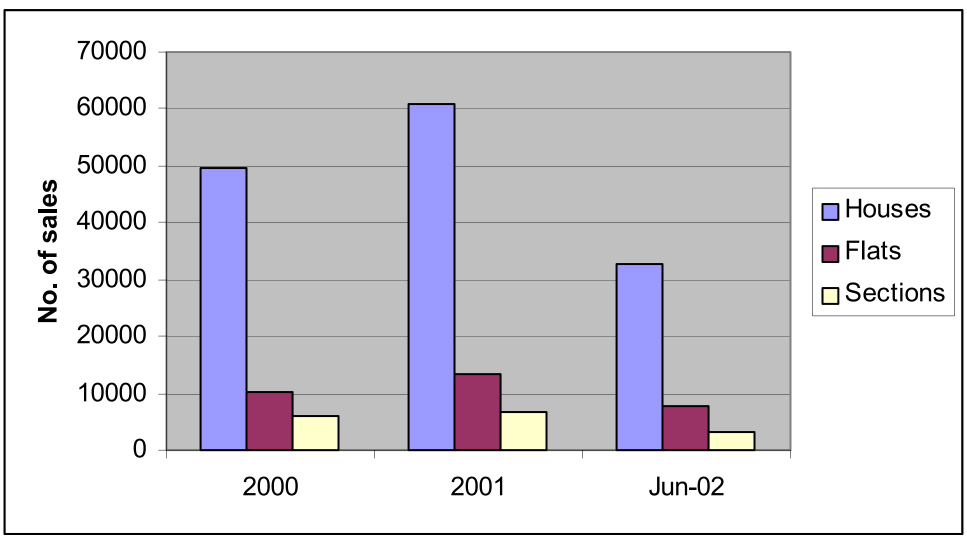
New Zealand

Currently in New Zealand it is a statutory requirement that each territorial authority maintain a valuation roll that includes assessed values for all separate properties. The values that must be placed on the roll for each property includes the capital improved value, land value and the value of improvements. Therefore, for each property three values are shown on the valuation roll. The benefit of having the three values is that it provides essential information for territorial authorities when undertaking incidence analysis as part of any proposal to change their rating system.

From a valuation perspective it means that Valuation Service Providers must undertake rigorous property market analysis to be able to identify both the value of the land (ignoring the improvements) and the capital improved value. This can be a particularly onerous task when the quantity and the quality of the sales transactions is limited.

This section of the report analyses the availability of transactions across New Zealand in general and then more specifically in relation to three main urban centres (Christchurch, Wellington and Dunedin). Figure 2 illustrates the volume of sales for houses, flats and undeveloped residential sections for the whole of New Zealand. It is clearly evident that the residential market is largely dominated by the sales of improved property. However, the market for undeveloped sections is relatively buoyant throughout New Zealand with sections representing around 13% of house sales. In general, there would be sufficient open market evidence to support both improved capital values and land value assessments.

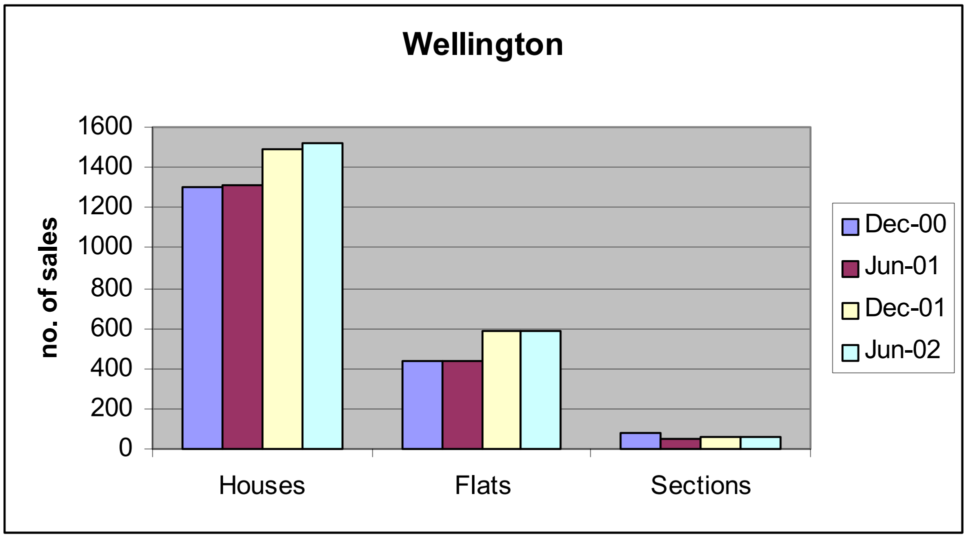
Figure 2: Sales of Dwellings, Flats and Residential Sections for New Zealand

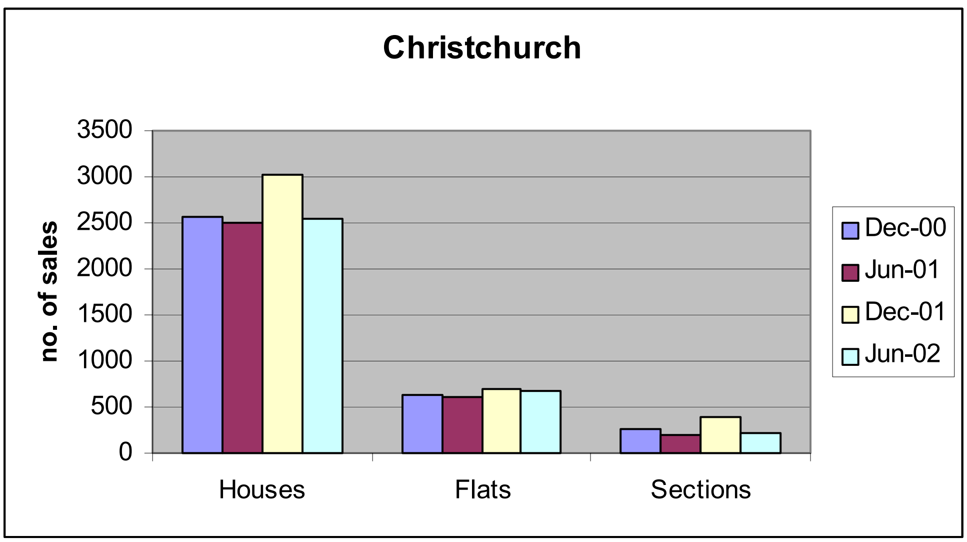


Source: Compiled from QuotableValue Statistics, Wellington

A similar picture to a large extent is present when one considers the urban areas of Christchurch, Wellington and Dunedin. Figure 3 show the number of sales across the three categories and again highlights the prevalence of improved value transactions.

Figure 3: Sales Figures for Wellington, Christchurch and Dunedin





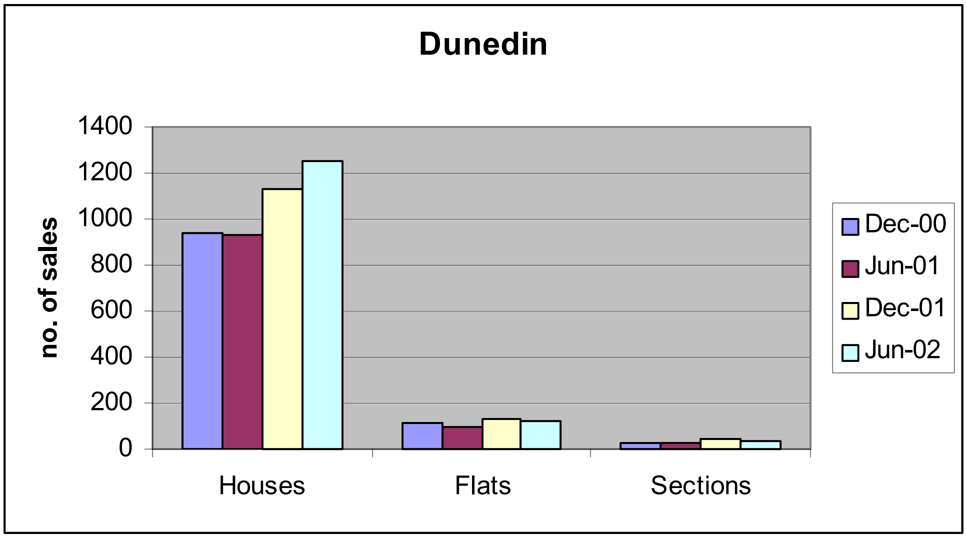


Figure 4: Number of Assessed Houses and Flats

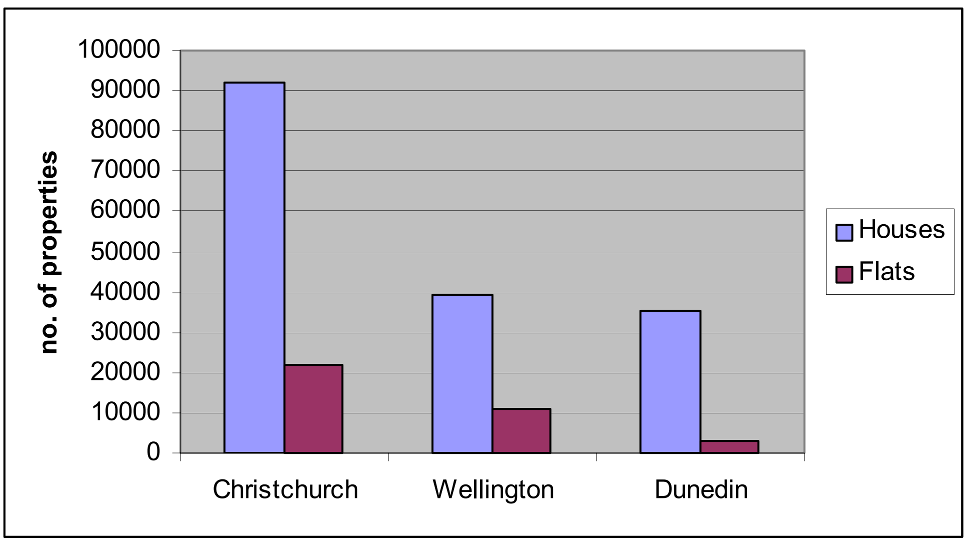
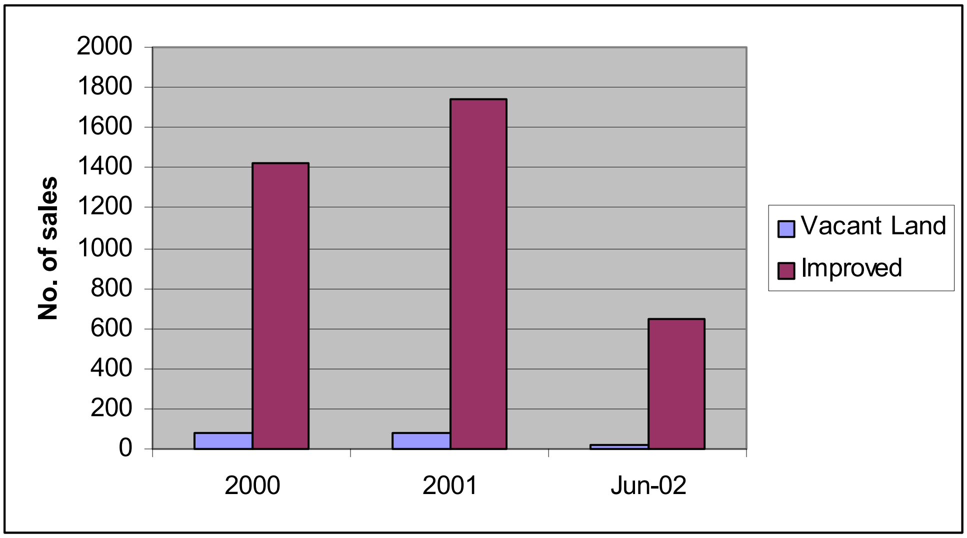


Figure 4 illustrates the potential scale of the assessment problem. For example for the city of Dunedin during a twelve month period there are on average 2,000 improved residential sales and approximately 75-100 vacant land sales. These sales once verified would form the basis of value to assess some 40,000 dwellings to both improved value and to land value. For Christchurch the figures are 5,000 improved sales and around 1,300 sections sold to value some 114,000 dwellings.

On analysis of these figures it is clearly an issue in trying to determine land values across all residential types given the low numbers of vacant land sales. The representativeness of the existing land sales would also be a potential problem.

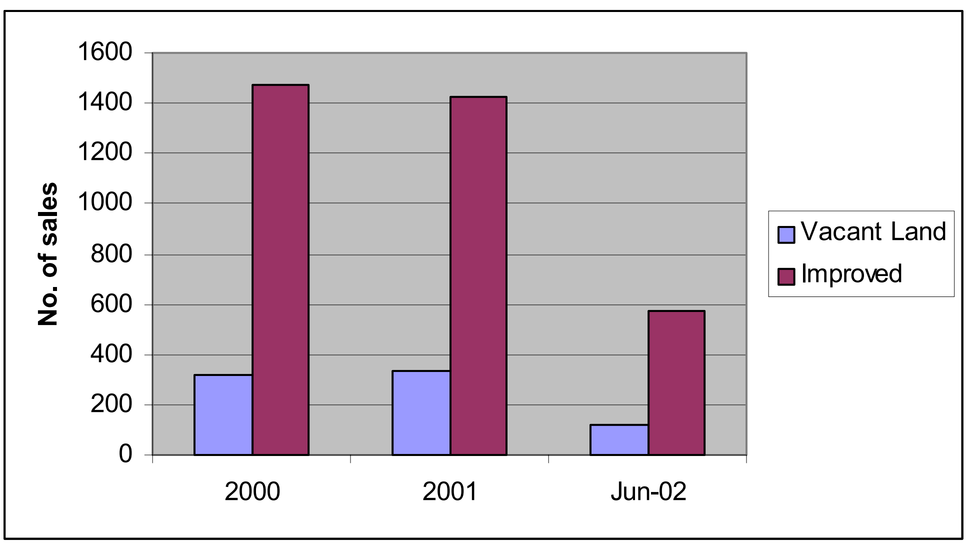
The assessment of commercial and industrial property represents a more significant challenge. As a generality given the size of these markets it is reasonable to assume that there will be a relative paucity of transaction evidence both in terms of improved values and also for land values. Figure 5 provides data on the number of sales for New Zealand.

Figure 5: Sales of Commercial Improved Properties and Vacant Land for New Zealand



With regard to commercial property there is a significant shortage of vacant land sales. For industrial property the same picture is presented as can be seen in Figure 6.

Figure 6: Sales of Industrial Improved Properties and Vacant Land for New Zealand



When one considers central business district areas the question of quantity of sales becomes more acute. For 2001 Table 3 shows the number of vacant and improved land sales in comparison to the total number of assessed properties.

Table 3: Vacant and Improved Land Sales Within the CBD: 2001

City	Number of assessments	Vacant land sales	Improved sales
Christchurch	3,778	3	30
Wellington	3,648	0	40
Dunedin	2,239	0	11

There is therefore a real lack of open market evidence upon which land values can be accurately and objectively determined for CBD areas.

From the New Zealand perspective there would appear to be data availability problems with specific regard to the assessment of land value for commercial property within urbanised areas. From an assessment perspective the few sales that do occur, both improved and vacant are intensively analysed in order to determined the underlying land value component. This devalued evidence is then extrapolated to develop a pattern of land values within CBD areas.

The problem is significantly less acute with regard to residential property. Within the three urban areas considered there are reasonable numbers of unimproved land sales. However, in each of the cases the number of unimproved land sections sold compared to improved dwellings represented 4 percent (Wellington), 3 percent (Dunedin) and 9 percent (Christchurch) over a twelve-month period. However, given the fairly homogeneous nature of land it is not unrealistic to assume that fewer land sales would be required. Compare this to the heterogeneous nature of improved property and the requirement to have considerable more sales to fully represent the population of property.

Therefore, from the statistics provided it is clear that the major areas of assessment/valuation concern would be related to the large towns and cities where unimproved transaction evidence is relatively scarce.

South Africa

For the largest part of the country, the Deeds Office keeps accurate and up to date records of any transfers of ownership or limited real rights in land. Where a property is sold, the sales price will also be reflected. Sales data is not confidential under South African law. The details of any property registered in the Deeds Office can be accessed electronically as can a list of recent property transactions. This generally provides municipal valuers with sufficient sales data and market evidence for rating valuations. Within the areas which formerly constituted ‘white South Africa’ there are well functioning capital and rental markets. This applies to urban and rural land.

However, in the black townships property markets are only now developing. A brief study by Franzsen and McCluskey in 1999 of valuation rolls for two rural towns (Leandra and Wakkerstroom) in the province of Mpumalanga indicated that the first attempts to include township properties in municipal valuation rolls resulted in inconsistencies and different approaches (McCluskey and Franzsen, 1999). The fact that all rural land is now within municipal boundaries also provides valuers with new challenges. The methodologies now being used for the valuation of tribal land and forms of communal land tenure have not yet been tested in the courts.

Maintaining the *status quo*, the Property Rates Bill, 2003 (clause 33(1)(a)) stipulates that only valuers registered with the South African Council for the Property Valuers Profession may be appointed as municipal valuers. Are there enough qualified valuers to undertake the task of preparing valuation rolls that – in principle – need to cover almost the total surface area of the country? And will these valuers be able to do comprehensive revaluations within the legally prescribed four- to the (maximum) five-yearly cycles (Franzsen and McCluskey, 2000)? Of the approximately 2,000 registered valuers, associated valuers and valuers in training, at most 20% are presently involved in municipal valuations (Zybrands, 2003b).

Some commentators argue that the number of rural properties (e.g. commercial farms) is not too large to present insurmountable problems. Furthermore, a number of local municipalities have been pro-active and have already started preparing new valuation rolls that extend to rural properties albeit under present provincial laws (Zybrands, 2003b).

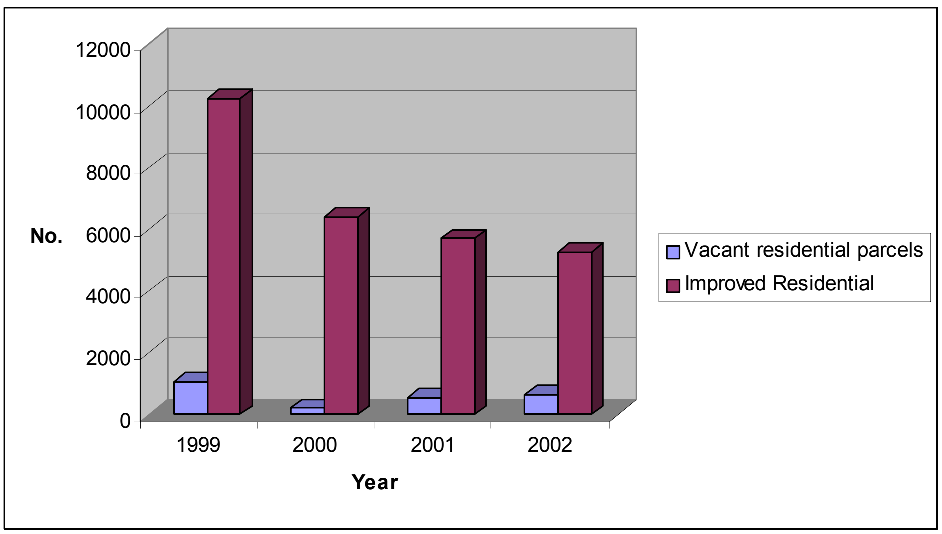
In terms of section 27(4) of the recently enacted Property Valuers Profession Act 47 of 2000 it will be possible for valuers, who are not registered in South Africa, to work ‘in the service of or by the order of and under the direction, control, supervision of or in association with a registered person entitled to perform the work identified and who must assume responsibility for any work so performed’. The City of Cape Town, using international consultants and local private valuers to assist its in-house valuation department, completed a computer-assisted mass appraisal (CAMA) general revaluation of more than 500,000 residential properties in June 2002 (Weichardt, 2003).

The South African Council for the Valuers Profession (the statutory regulatory entity) as well as the South African Institute of Valuers (a voluntary professional association for the valuers profession) seem confident that although the Property Rates Bill provides the valuers profession with a huge challenge, the capacity indeed exists to take on the task at hand (Zybrands, 2003a). Much depends, however, on the attitudes and vision of municipal valuers and municipal councils. Unfortunately some councils, as well as some municipal valuers, are opting to wait until the Property Rates Bill is enacted before doing anything (Zybrands, 2003b).

Whether site rating provides the best option for rating purposes, especially where there is at least some doubt about the professional capacity, is not clear. The problem, as is the case in New Zealand, is not the extension of valuation rolls to the relatively few rural properties, but how to deal with the substantial numbers of urban properties.

Generally speaking the assessment of site value is usually straightforward where evidence of demand is present and good sales are available. However, in the highly developed inner cities of South Africa, vacant land sales are indeed posing a problem for municipal valuers. A paucity of undeveloped sites may also have the result that those remaining sites command very high, somewhat unrealistic comparable values. Valuers will sometimes have to rely on sales from adjacent neighbourhoods to provide an indication of land values. Figure 7 illustrates the sales of vacant and improved residential properties over the period 1999-2002. Whilst there are no fundamental conceptual problems in valuing land for taxation, there can be difficulties in practice particularly for commercial areas. (McCluskey and Franzsen, 2001; Bell, 2002).

Figure 7: Sales of Vacant and Improved Residential Parcels: Tshwane Metropolitan Area



Source: Tshwane Valuation Department, Pretoria

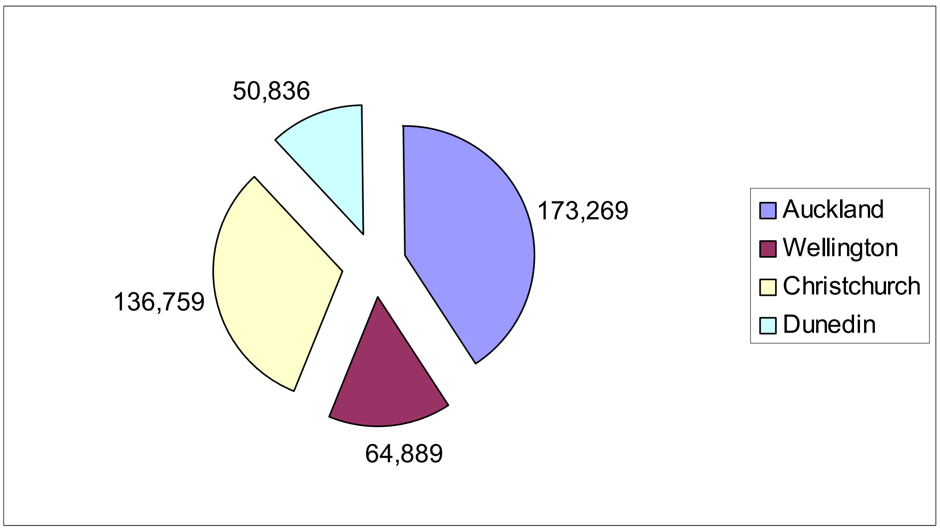
Computer Assisted Assessments

New Zealand

In New Zealand revaluations are undertaken on a three-year cycle, however, not all of the 74 territorial authorities are valued at the same time, but rather a rolling type of revaluation structure is employed. This effectively means that approximately one-third of TAs are valued each year. As of 2001 there are approximately 1.68 million rateable properties in New Zealand. Figure 8 illustrates the tax base in the four largest urban cities.

Local authorities appoint their valuation service providers (VSP) through a process of competitive private tendering. Currently, the private sector can compete against the Crown owned entity (Quotable Value) for local authority rating valuations. Given the scale of the revaluations most, if not all, VSP's employ automated valuation procedures. The principal methodology employed involves the use of indexation. In simple terms the previous assessed value is indexed to reflect changes in value between the revaluation dates. The procedure involves analysing sales around the revaluation date and determining the index value, which represents the change in value of a property. Indices are calculated for homogeneous groups of properties according to type, age, style and location.

Figure 8: Number of Assessments in the Four Main Cities (2001)



This methodology is not based on discrete revaluations of each property, but rather uses comparable sales evidence to determine the shift in property values between the revaluation dates. It does assume that the previous assessed value is correct and unless the previous value has been objected to, this would appear to be a valid assumption. There is also a requirement that all sales around the revaluation date be verified and inspected to ensure that the sales information is accurate.

New Zealand has developed the automated approach of indexation to a high degree. The overall process is based on market transactions and as such is objective. The general public accept the approach as being relatively fair.

One of the main deficiencies of the indexation approach is in determining land value indices in the absence of sufficient transactions. It would not be unreasonable to suggest that for inner city urban areas that indices are based on relatively few transactions (see Figures 5 and 6).

South Africa

Generally the outdated provincial laws in most cases still stipulate that each rateable property has to be physically inspected by the municipal valuer, severely hampering the use of computer assisted mass appraisal techniques. This however, did not prevent the extensive use of computers in data collection and maintenance and in the preparation and manipulation of valuation rolls – especially in the case of some of the larger municipalities (e.g. the City of Tshwane (Pretoria)).

In 2000, section 11 of the Local Government: Municipal Structures Amendment Act 33 of 2000 amended the Local Government Transition Act 209 of 1993 by the insertion of subsection (6A) in section 10G of that Act which has application throughout the country (i.e. in all 9 provinces). Section 10G(6A) states:

a) 'Despite anything to the contrary in any other law, a municipality must value property for purposes of imposing rates on property in accordance with generally recognised valuation practices, methods and standards.
b) For purposes of paragraph (a) –
    (i) physical inspection of the property to be valued, is optional; and
    (ii) in lieu of valuation by a valuer, or in addition thereto, comparative, analytical and other systems and techniques may be used, including –
        (aa) aerial photography;
        (bb) information technology;
        (cc) computer applications and software; and
        (dd) computer assisted mass appraisal systems or techniques.'

Echoing the wording of section 10G(6A) of the Local Government Transition Act (as introduced in 2000), the Property Rates Bill explicitly provides that physical inspection of property is optional and that a municipal valuer may use CAMA techniques (clause 38).

However, providing explicitly for valuation techniques and methodology in legislation has received criticism from the valuation profession as being too prescriptive. These issues should rather be left to the property valuers' profession to decide in the context of international best practice (Zybrands, 2003a).

Analysis of Questionnaire Responses with Respect to an Appropriate Property Tax System

This section of the report provides the results of a questionnaire that was sent out to all 74 territorial local authorities in New Zealand and seven municipal valuers in South Africa. From a New Zealand perspective the questionnaires were targeted at the person in the local authority who would have a reasonable depth of knowledge on their respective rating systems. This either meant the Rating Officer (if the council had one) or the Financial Director. The main aim of the questionnaire was to attempt to elicit responses from each council with respect to a number of key questions. Some 53 local authorities replied which resulted in a response rate of 72%.

In relation to South Africa, given the state of flux, it was thought impractical to send the questionnaires to all of the newly established metropolitan and local municipalities (237 in total). The questionnaire was therefore distributed to a very limited number of seven individuals involved with municipal valuations or finances. Only in the case of Langeberg local municipality (LM) was the questionnaire completed by the municipality's assistant financial officer. Valuers completed all six other questionnaires. Despite the fact that only seven questionnaires were completed, these do represent different categories of municipalities across six provinces. There is one metropolitan municipality (Tshwane MM), three local municipalities dominated by a secondary city (George LM, Polokwane LM and Potchefstroom LM), and three local municipalities which are more rural in character, i.e. with a number of smaller towns (Dihlabeng LM, Greater Tubatse LM and Langeberg LM).

Table 4: Municipalities that Responded to the Questionnaire

Municipality	**Province**	**Rating system**	**How long?**	**Reviewed in last 10 years?**
Dihlabeng LM	Free State	Composite	25 years +	No
George LM	Western Cape	Composite	25 years +	No
Greater Tubatse LM	Limpopo/Mpumalanga	Site	80 years +	No
Langeberg LM	Western Cape	Composite	15 years +	No
Polokwane LM	Limpopo	Site	50 years +	No
Potchefstroom LM	Northwest	Site	25 years +	No
Tshwane MM	Gauteng	Site*	50 years +	Yes*

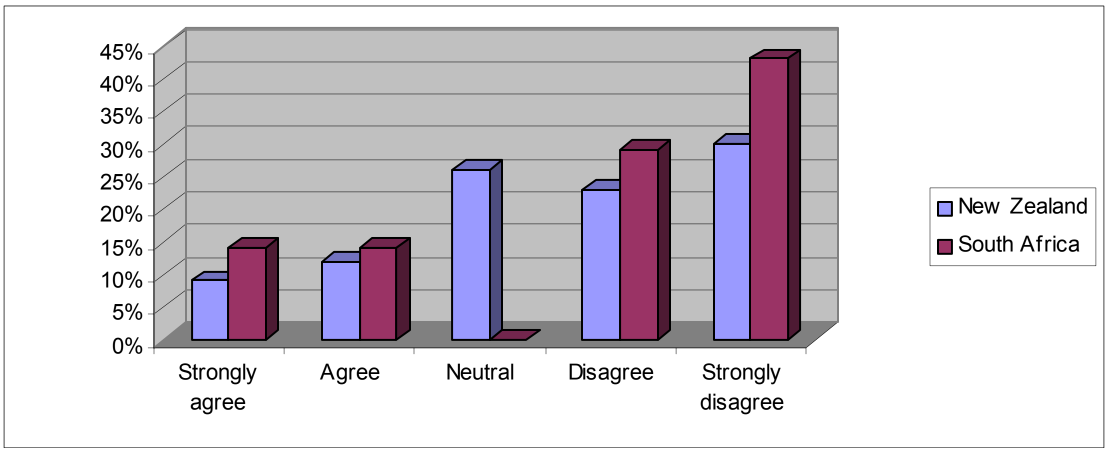
Note: Tshwane introduced composite rating for a two-year period only (1997/98 and 1998/99).

The first striking feature is that all seven councils have been using their current system for a considerable time and without contemplating any changes. It is only in Tshwane Metropolitan Municipality (Pretoria City Council as it then was) where a tax on the value of improvements was levied as a temporary measure for a two-year period only. The fact that no reviews have been undertaken in the last five years, confirms the statement that councils are generally adopting a 'wait-and-see' approach to the Local Government: Property Rates Bill. However, it must be remembered that – from a valuation point of view – valuation rolls generally already contain at least two values (i.e. land value and value of improvements) or three values (i.e. land value, value of improvements, and the improved value). Therefore, changing to a new basis will not be too difficult. From a property tax point of view, however, changing the tax base may have a severe impact on tax incidence.

Analysis of Opinions

Local authorities in New Zealand when asked whether land value rating was a more appropriate mechanism to recover the cost of council services some 21% of respondents tended to agree that it was the most appropriate basis (for their local authority), whereas the majority of respondents, some 53% disagreed (see Figure 9). Clearly, there is a fairly widespread view that land value (on its own) is not the most appropriate funding mechanism for the recovery of local service costs. A similar pattern also emerged from the responses from valuers in South Africa, where the majority of valuers tended to disagree that land value was the most appropriate basis.

Figure 9: Whether Land Value is the Most Appropriate Basis for the Tax



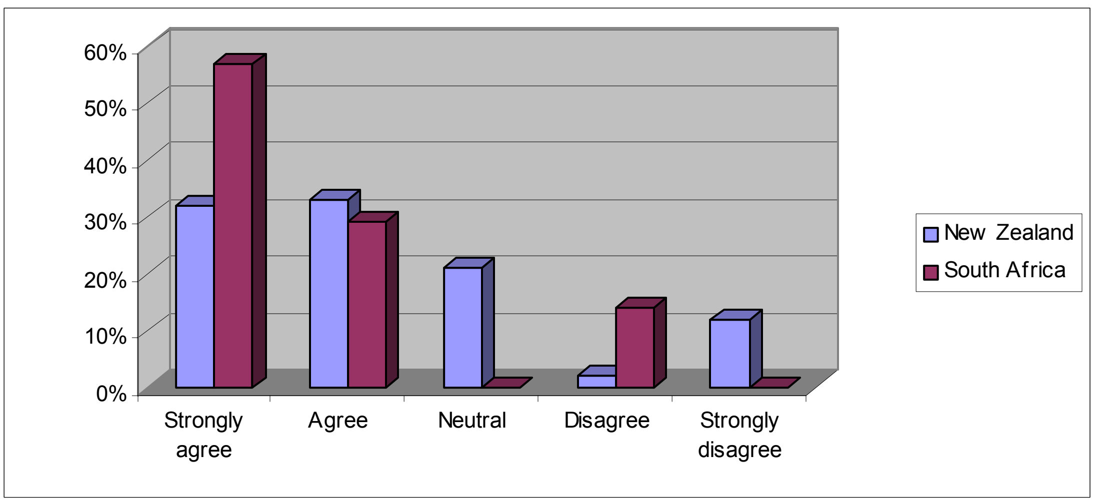
In contrast the response to whether capital value was the most appropriate tax base there were a variety of comments made by the New Zealand respondents. In relation to whether capital value was a more appropriate funding tool some 53% were in general agreement with only 14% in disagreement (see Figure 10).

It was considered that as council services properties as well as residents, a mix of land value and capital value would be a more appropriate option. People related services were better reflected by capital value whereas property related services are best recovered by Uniform Annual Charges. In addition, it was considered that the most appropriate method of recovering the cost of services is user-pays levied for each service used. Other responses included the fact that land value does not represent the full value of the district. There was a perceived lack of sales information. Furthermore wide fluctuations in land values created large fluctuations in rate levied. Additional comments made by councils with regard to capital value included the fact that capital value suffers from more value-based distortions than land value. In addition, it was felt that as the level of services does not increase on higher valued properties they should not be penalised. Equally, it was considered that capital value tends to be less fair to lower income/socio-economic groups.

Of the three systems in South Africa responses were significantly in favour of flat rating, or, as an alternative, composite rating. In other words, a system that also taxes the value of improvements was preferred by a majority of the respondents. Only one respondent favoured site rating on the grounds of its administrative simplicity in comparison to a system that includes improvements.

Considering the question of whether land value was more suited to a rural local authority than an urban one (see Figure 11), some 35% of the respondents in New Zealand and 28% in South Africa tended to agree with the statement. On the other hand 49% and 56% took the alternative view in New Zealand and South Africa respectively. Other comments made by respondents included the fact that most of the value of rural property is in the land value, which then requires greater use of differential tax rates to balance the rate take with other categories of properties.

Figure 10: Whether Capital Value is the Most Appropriate Basis of the Tax



In many respects one could conclude that the differentiation between land value and capital value in a rural context can be considered as largely irrelevant.

From a New Zealand perspective respondents when asked to consider whether capital value is more suited to a urbanised local authority some 40% were generally in agreement whilst 28% disagreed (see Figure 12). Again, there is no absolute evidence that demonstrates that capital value is a more appropriate basis for urban areas. In South Africa there was significant disagreement that capital value was the most appropriate option within an urban context.

In relation to taxpayer understanding of the property tax basis, respondents in both New Zealand (51%) and South Africa (58%) were generally of the opinion that capital value was the easier to explain to taxpayers and for taxpayers to ultimately understand (see Figure 13).

Figure 11: Suitability of Land Value in a Rural Context

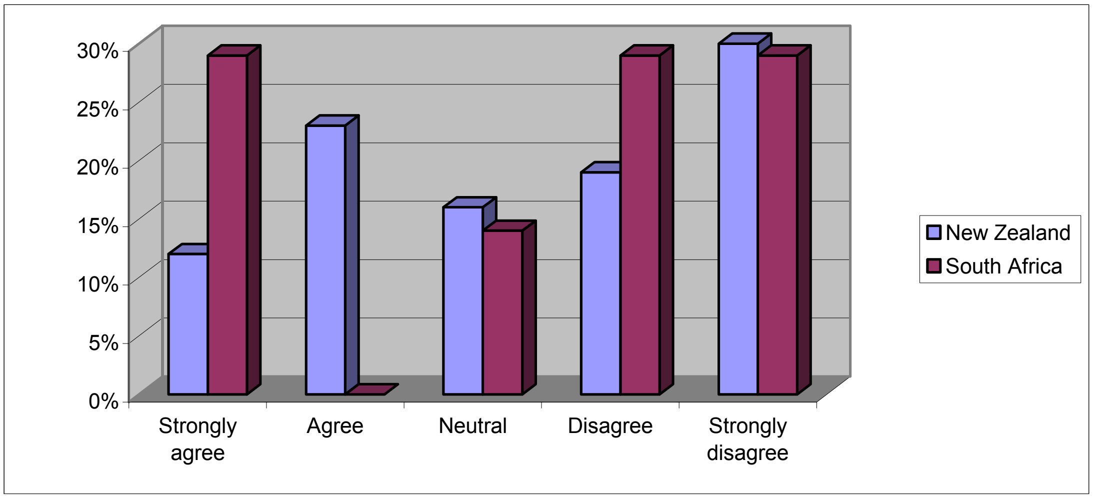
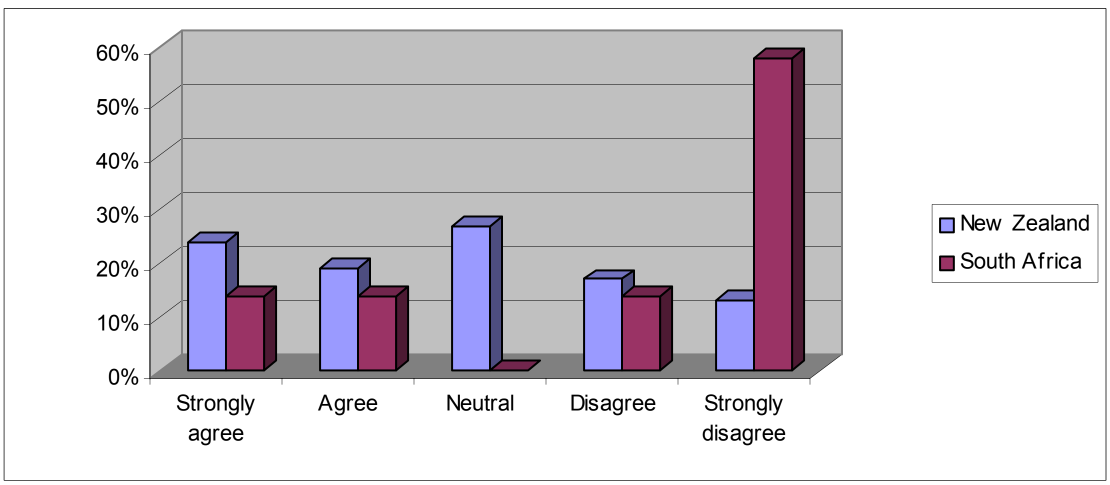


Figure 12: Suitability of Capital Value in an Urban Context



From a South Africa perspective it is usually accepted as trite that a flat rating system is easier to understand – in respect of developed land. However, some respondents suggested that site rating could be the easier. Although the sample is too small to be of any statistical relevance or to draw any meaningful conclusions, it does provide an interesting perspective on the current debate on property tax reform in South Africa. It does show that there are differences of opinion, even within the valuers' profession. The fact that the Institute of Valuers officially support flat rating as opposed to site rating, and that individual valuers responsible for site value valuation rolls also support the valuation of improvements do not seem to have much sway with municipal councils still using site rating.

In relation to promoting and encouraging the development of vacant or under-utilised land. Some 45% of respondents in New Zealand were clearly of the view that a tax on land value does act as an incentive to develop land to its highest and best use whilst some 26% tended to disagree (see Figure 14). Other comments suggested that such a position only holds when there is effective demand for the property.

The position is largely the same in South Africa where the majority of respondents were of the view that land value tended to encourage development (72%). Respondents felt strongly that site value does not penalise the development of land and that a system that taxes improvements, especially at the same rate as the land, may indeed be a disincentive to develop land. However, one respondent pointed out that rating is usually a relatively minor consideration when a decision is made to develop or not develop land with other factors driving these decisions.

Figure 13: Level of Taxpayer Understanding of the Basis

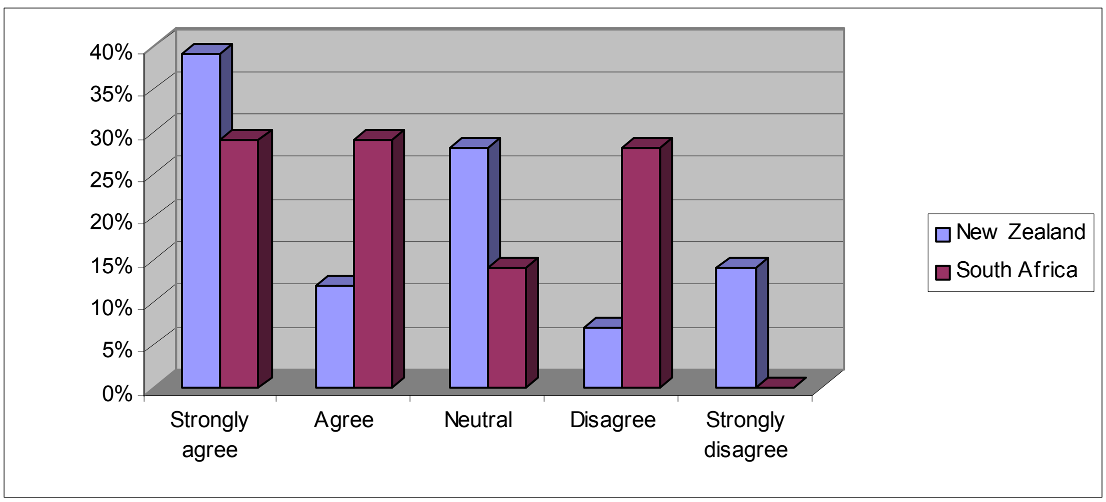
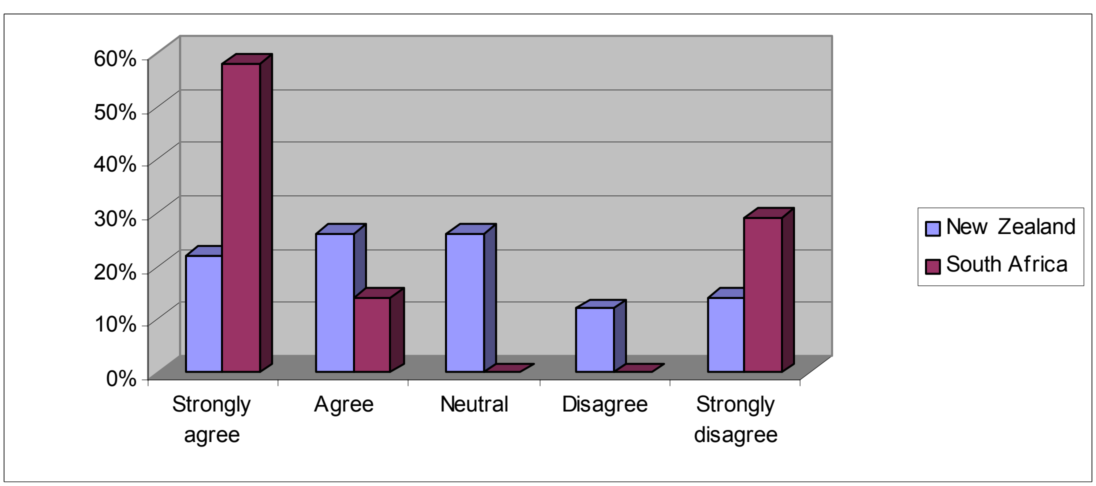


Figure 14: Role of Land Value in Encouraging Development



With regard to the question as to whether capital value discouraged property development, the New Zealand respondents were of the view that capital value did not encourage or promote the development of vacant or under-utilised property (49%) (see Figure 15). It was also a view that the development or redevelopment question did not materially depend upon the effect of a future rating liability. Whereas in South Africa some 72% of respondents did not agree that capital value actively discouraged the development of property.

A question was posed as to whether a land value system created a narrow tax base. In this regard it was concluded by the majority of respondents in New Zealand and South Africa that land value systems do in fact create narrow tax bases (68% in New Zealand and 86% in South Africa; see Figure 16). However, respondents did recognise that some growth in the tax base is to an extent possible with sub-divisions.

Figure 15: Role of Capital Value in Encouraging Development

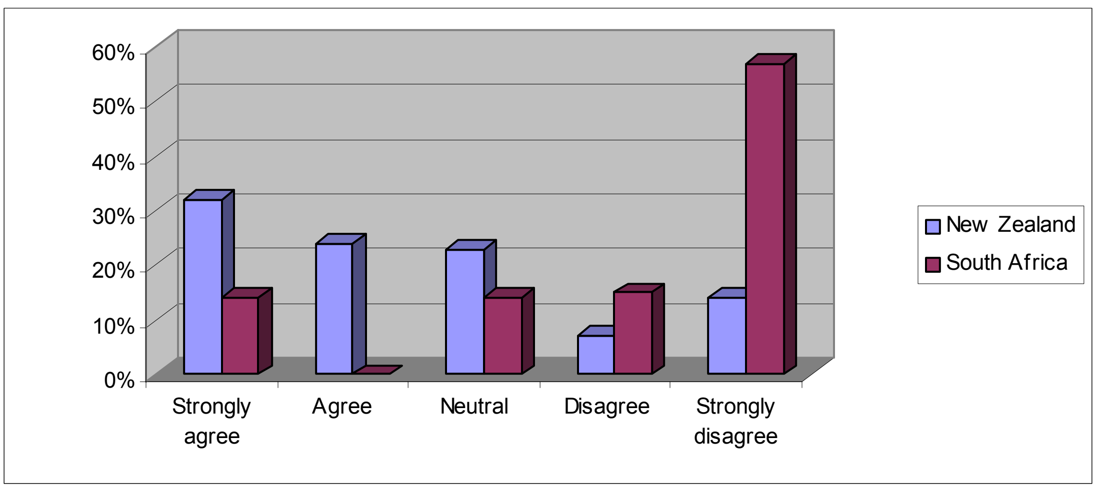
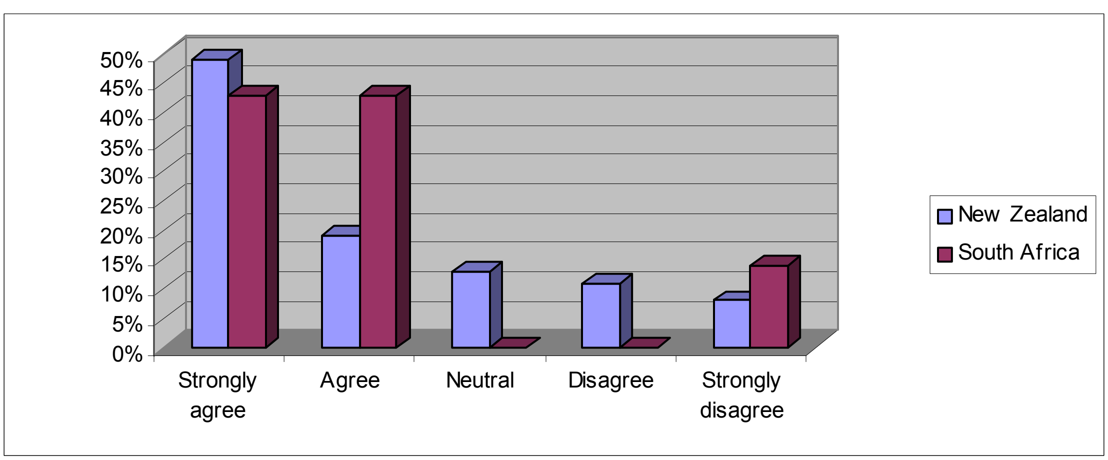
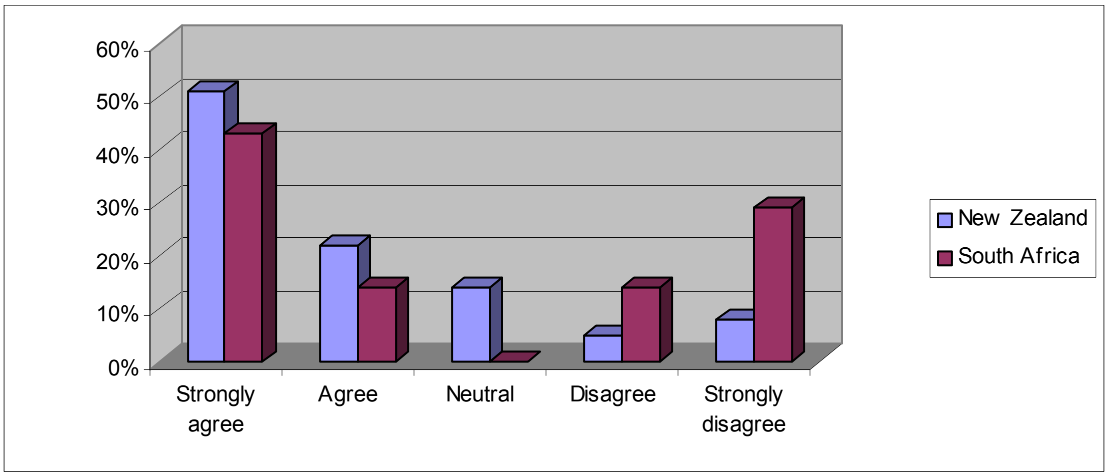


Figure 16: Size of the Tax Base Under Land Value



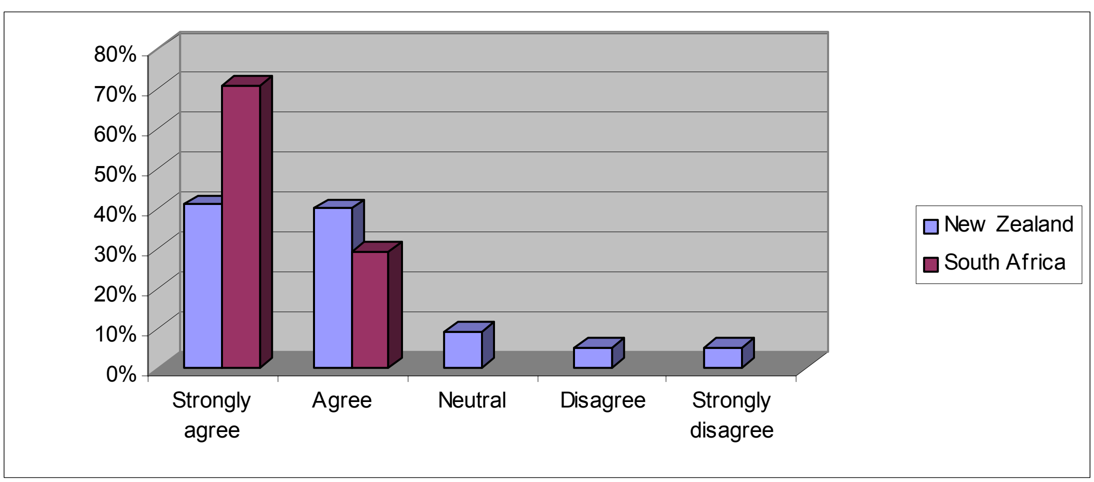
Developing this concept further respondents were then asked to comment on whether capital value constituted an expanding tax base (see Figure 17). Some 73% of NZ respondents and 57% of South Africa respondents agreed that a capital value base can more readily expand with new development and the additions and improvements to existing property.

Figure 17: Size of the Tax Base Under Capital Value



By taxing improvements to land as well as the land component a major element of taxpayer wealth is included in the tax base (see Figure 18). Some 82% of respondents in New Zealand and 100% of South African respondents generally agreed that by taxing improvements this aspect of taxpayer wealth was included within the local tax net.

Figure 18: Extending the Tax Base to Include Improvements



General Debate Regarding an Appropriate Property Tax System for South Africa

Significant reforms have been occurring within the local government sphere in South Africa since 1994, but especially since 2000. Many structural adjustments were required and are still being attended to. There are pending changes to the rating dispensation, which will most likely imply the exclusive future use of flat rating (i.e. capital values only). Some of the amalgamated municipalities are in a difficult process of unification of different rating systems and a multiplicity of valuation lists with different effective dates. Many municipal councils seem to adopt a "wait and see" approach whilst maintaining the *status quo* as an interim measure. Lastly, many of the newly-appointed treasurers, municipal directors and most councillors have had limited or no experience of the currents and past practices regarding municipal valuations and choices made regarding rating systems.

Movements Towards Capital Improved Value Systems

In South Africa, property taxation - including the choice of tax base - has become highly politicised in recent years. Although all three traditional tax bases are presently still being used extensively (Kapp, 1998; Bell, 2002), once the Local Government: Property Rates Bill has been enacted (probably by July 2004), there will be one rating system only. As indicated above, once the Bill is enacted, site rating and composite rating will belong to the past.

A number of large urban municipalities in South Africa (e.g. Johannesburg and Pretoria) have been using site rating for many years. Cape Town recently (1997-1998) contemplated a change from capital improved rating to site rating. The Valuation Ordinance of 1993 was amended to actually provide that should site rating be chosen, there was no need to also value the improvements (Van Ryneveld and Parker, 2002). Site rating was however not implemented, as it became clear that a change in the base would have resulted in tremendous shifts in incidence. Other reasons cited include (Van Ryneveld and Parker, 2002):

- Delays with the national framework legislation on local government generally;
- The creation of single-tier metropolitan municipalities which necessitated a single, uniform rating system throughout the metropolitan area; and
- National government indicated its preference for a rating system based solely on the improved value of property.

In South Africa the view is held in some circles that property tax is indeed a wealth tax, and that therefore improvements should be included in the base as these usually represent a considerable portion of the total value of a developed property (Manche, 2003). However, Bahl (2002) points out that there

> 'is another perceived advantage of a capital value tax (probably wrongly held) that a tax on land and structures will fall more heavily on businesses, landlords, and wealthy residential homeowners, than will a land value tax, i.e., it will be

> more progressive. This perception could resonate well with the large population of South African poor. However, contrary to intuition, taxing land and improvements may be less progressive than a land-only tax. For one thing, landowners are heavily concentrated in the upper income brackets. Another issue is that a tax the tax on improvements could drive investment away from real estate, reducing the supply of structures and forcing up rents. Vertical equity may be an argument in [favour] of the land value base.'

It must also be kept in mind that a tax on business properties can more readily be shifted onto consumers (Bahl, 2002) – including the poor who supposedly benefit from taxing these properties more heavily.

An advantage that a capital value tax base has, in comparison to a land-only base, is that it allows for lower nominal tax rates (Bahl, 1998; Bahl, 2002). This makes it politically more acceptable.

When the Local Government: Property Rates Bill is enacted, it will bring about substantial reforms to the property tax dispensation in South Africa. Earlier calls for a uniform tax base have indeed triumphed. The South African Institute of Valuers, representing the valuers' profession, officially also support capital improved values as the preferred tax base, citing lack of public understanding of a land value system, as well as the lack of vacant sales within CBD areas as primary reasons. Further reasons cited in the valuer questionnaire include that with capital improved values the valuation roll automatically provides data on all improvements and other new developments, capital values provide a more buoyant revenue base than land only and can achieve a better distribution of the tax burden.

However, certain interest groups argue against the taxation of improvements, claiming that it would stifle development or even result in the demolition of existing improvements (e.g. farm labourer dwellings). Various international studies indicate that there are inconclusive results about whether a land-value only tax base leads to the more efficient use of urban land (Bahl, 2002).

Probably the most-often cited argument in favour of a site-value tax is its assessment advantage (McCluskey and Franzsen, 2001; Bahl, 2002; Bell, 2002; Van Ryneveld and Parker, 2002). Clearly the valuation roll can be prepared and maintained more cheaply and uniformly if improvements are not included in the tax base. However, this very real advantage is not presently available in the context of South Africa. The current provincial laws require that irrespective of the tax base utilised in practice, the valuation roll must reflect two (i.e. land and improvements) or three values (i.e. land, improvements and capital value). Only the Cape Valuation Ordinance, 1993 was recently amended (Van Ryneveld and Parker, 2002) to make it possible to value only land should a council opt for site rating.

South Africa's property tax reforms are not primarily driven by valuation considerations, but rather by socio-political considerations.

Conclusions

In this concluding section of the report we attempt to deal with a number of research questions that are of some significant importance to both jurisdictions. It is also an opportunity to draw the various research strands together to see the overall picture that has emerged during the progress of this work.

Can specific conditions be identified as optimal for the use of land value taxation?

The pattern of local government property taxation in New Zealand has been undergoing a significant process of evolution, particularly, over the last 30-40 years. Local authority reliance on land value has been challenged by virtue of the fact that capital value rating is becoming more widespread. As local authorities are given a choice as to which rating system to use they are clearly opting for capital value. Valuation factors may be relevant in that as areas are developed there is less and less sales evidence of undeveloped land. Therefore, valuers must extrapolate sales data over a much wider geographic areas to maximise the use of limited sales evidence.

Similarly, in South Africa local government has undergone material structural reforms since 1993. The *White Paper on Local Government*, published in March 1998, also proposed material changes to the manner in which local government is to be financed, citing certain features of the property rates dispensation that required reform. And indeed the *White Paper* (i.e. government policy advisors) suggested a simpler and uniform valuation system with regards to tax base is one of the key policy objectives of a future rating dispensation. It is, however, also stated that a 'key decision that needs to be taken is whether there should be uniform national system, or whether there should continue to be local choice in this matter'. In essence the *White Paper* suggests uniformity, but leaves the question which of the three systems in operation in South Africa is to be preferred, unanswered.

The mere existence and perseverance of the three systems in South Africa for at least 100 years, each with a significant following (Kapp, 1998), suggest that there must be some merit in all three systems. Traditionally, legislation prescribed that the municipal valuer has to value land, improvements and the total value of each rateable property – in other words, the choice of tax base was primarily a political decision. Although difficult if not impossible to quantify, the importance of retaining the system with which one is most familiar should not be underestimated as a major factor. This is underscored by the data provided in the questionnaires – where all of the present tax bases have been in operation for longer than 15 years.

Despite the dramatic political and constitutional changes, South African municipalities seem to have retained the systems that were in place and with which they were familiar after 1994. However, within the context of property tax reforms being proposed in the *White Paper*, many municipal valuers in South Africa (admittedly mostly those operating in metropolitan areas) have been arguing for uniformity and also for the migration to capital values. Not surprisingly, the principle argument used is the paucity of reliable data within built-up areas (especially CBD areas) in especially the larger urban jurisdictions. Policy makers within the relevant government department, the Department of Provincial and Local Government, also canvassed strongly for uniformity. Furthermore it was argued that capital improved values provide a more equitable and broader tax base that also reflects a taxpayer's ability to pay rates more appropriately. The responses to the questionnaire generally confirm this view. So the tide is turning against site rating.

Is land valuation administratively simpler and easier to apply? And to what extent is this conditioned by the type of urban/rural area?

From an administrative perspective land value must be the easier of the three rating options available in New Zealand. Both capital value and annual rental value has as a requirement to value improvements. This involves maintaining an accurate inventory of improvements on each rateable property. The implication is, that, as improvements change so should the assessed value. A system that values improvements has a more significant resource cost.

In South Africa flat rating and composite rating both require the valuation of improvements. This involves maintaining an accurate inventory of improvements on each rateable property. However, provincial legislation (except in the Western Cape) dictates that a valuation roll must include two or three values (i.e. land only, improvements, and capital value) in any event, irrespective of the actual tax base utilised by a municipality. In practice, however, valuers in some of the councils that used site rating admit that they place less emphasis on the accuracy of the values of improvements and rather ensure that the value of the land, being used as tax base, is a more accurate approximation of market value.

In the context of the new local municipalities that consists of urban and rural properties, it could possibly be argued that a land value system could indeed be less cumbersome. A system that values improvements has a more significant resource cost as it requires a more significant initial input, regular supplementary valuations (i.e. more extensive maintenance), regular revaluations and, being less homogenous, provides less scope for the possible introduction of (annual) indexation.

As in the case of New Zealand, it is argued that as areas are developed there is a dearth of sales evidence of undeveloped land. The lack of evidence of sales in inner city suburbs may not be as convincing with regard to less developed urban and especially rural areas. However, the suitability of site rating in rural areas was not confirmed by the South African responses to the questionnaires. It was found that as there are generally few improvements in rural areas, the inclusion of improvements in these areas do not pose a major problem to valuers.

What factors are influential in the decision making process of a jurisdiction when deciding on the basis of the property tax?

The principal objective of whichever rating system is to be used is to ensure that there is an equitable and fair distribution of the rates burden across all property types within a local authority jurisdiction. The system should ideally endeavour to be uniform, just, honest, credible, impartial, unbiased and appropriate given the circumstances under which it is to operate.

Generally, the valuation and the rating system should provide as few distortions as possible to economic activity. The obvious exception would be to penalise or discourage particular kinds of activity. The tax base for rating should be wide and clearly defined. A tax levied on a wide tax base causes less distortion than one spread more thickly over a smaller tax base. There should be few (and simply defined) exemptions, because they narrow the tax base and create opportunities for avoidance. The rating and valuation tools should be as transparent as possible to allow taxpayers to clearly identify the impact of rates on them.

It is often stated as that taxpayers will generally have less trouble to understand capital values as tax base than site value. However, in a South African context where the vast majority of ratepayers are not familiar with even the concept of 'market value' (as markets in former townships are only now emerging and in tribal areas the concept of private ownership is foreign and sale of property not possible) or with the concept of any form of rating, this argument may be less convincing.

In reality, historic patterns as well as social and political realities are the more important factors that a specific municipality or a government will consider in deciding on the most appropriate system. As indicated by Bell (2002) it is usually a weighing up of financial and political considerations against economic and administrative considerations. As suggested above, tradition is also an important factor.

To what extent do property market characteristics influence the choice of property tax? What impact, if any, does the contracting out of valuation services have on the provision of assessed values?

To a large extent the rating basis should have some correlation to the property market. For example, both Hong Kong and Singapore use the annual rental value system reflecting the abundance of open market lettings of properties. The level of owner occupation in both of these jurisdictions is relatively low given the high prices of property. Where owner occupation, particularly for residential property is greater than say, 60%, then there is a strong argument that capital value rating, from a valuation perspective should be the preferred option. Having sufficient transaction evidence allows for the transparent defence of the assessed values during objection and appeals processes. In New Zealand, local authorities through a process of private tendering can select their valuation service provider. This to some extent has removed the monopolistic control that central government had over the supply of rating valuations to local government. The private sector can bid for such rating valuations against the government provider. This change in opening-up the valuation provision has had less than a significant impact. Only a few of the 74 local authorities use private sector providers, with the majority of councils opting to retain the services of the government supplier.

In South Africa, a well-developed capital and rental markets have been in existence in former white South Africa. Annual values were never used as a tax base, although rental evidence is sometimes used to determine capital values.

The metropolitan municipalities and some of the other larger primarily ‘urbanised’ municipalities (mostly secondary cities under the previous local government dispensation) have in-house valuation departments. These departments have developed their own unique in-house methodologies – which could suggest a reluctance to change. However, Tshwane Metropolitan Municipality (formerly Pretoria City Council) did, for a two-year period also rate improvements. Because the valuation roll contains at least two values for all rateable in any event, migrating to another system does not depend too heavily on the valuation profession’s preference generally, or that of the municipal valuer more specifically, but rather on how to spread the burden more effectively (not necessarily more fairly) amongst the ratepayers.

In the case of smaller municipalities, valuation service providers are selected through a process of private tendering. Again, as valuation rolls still have to reflect all three values, the choice of tax base is not so much an issue to be decided by the valuation service providers, but rather by local politicians.

Irrespective of whether valuation rolls are prepared in-house, or by private valuers (i.e. outsourced), or by a government agency (not applicable in South Africa), external, independent quality controls are essential. Individual owners can object and appeal individual values. However the integrity of the total roll should also be monitored. This form of control has to date not existed in South Africa. However, external quality control will be introduced when the Local Government: Property Rates Bill, 2003 is eventually enacted.

What are the implications and potential for automated mass assessment and the use of geographic information systems?

Rating valuations provide for an excellent opportunity to employ computer assisted valuation methods. When one considers the scale of the valuation task, which, from New Zealand’s perspective is every three years the role of automation is of fundamental importance. Computer generated valuations have been used in New Zealand for well over two decades. The current methodology is one based on the indexation of the previous assessed value. The system meets the requirement of being relatively simple to apply and understand. In addition, the taxpayers have accepted that the approach produces relatively fair and consistent assessments.

Computer generated valuations have not been used in South Africa until recently, although some automation has been in place in the case of the larger metropolitan municipalities. Until amendments introduced nationally in 2000, legislation required physical inspections of each rateable property. However, in terms of overriding national legislation (by insertion of a subsection in the Local Government Transition Act in terms of the Local Government: Municipal Structures Act) it is now possible to utilise CAMA in the preparation of municipal valuation rolls. As indicated above, the City of Cape Town has completed its first CAMA valuation roll (for more than 500,000 residential properties) in June 2002 (Weichardt, 2003). Pilot studies in rural jurisdictions in the North West and Free State provinces indicate that CAMA could also be extended to non-metropolitan municipalities (Ward, 2002).

Whether the taxpayers will accept that a CAMA approach can produce relatively fair and consistent assessments of property values, remains to be seen.

To what extent can the lessons learned in New Zealand and South Africa be applied to other jurisdictions in other parts of the world who are considering the possible introduction of land value taxation?

With its somewhat unique history of site, flat and composite rating, South Africa may indeed provide valuable lessons for jurisdictions contemplating a change of their system(s), be it to a land, composite or improved value system.

Problems experienced during the five-year long drafting process suggest that any changes to the tax base which significantly impacts on the assessment of properties for rating purposes need to be discussed in detail with the valuers profession. It is this profession that will ultimately be responsible for the preparation and maintenance of municipal valuation rolls.

Although the system eventually enacted needs to be sustainable (i.e. the necessary capacity and professional skills must exist to implement and sustain it), it also has to be politically acceptable. As stated above, it is generally a balancing of interests (Bell, 2002), weighing the political and financial concerns against the economic and administrative concerns.

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