

# **EXPOSURE DRAFT OF PROPOSED INTERNATIONAL VALUATION APPLICATION — MASS APPRAISAL OF REAL PROPERTY**

*Comments to be received by 31 December 2002*

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# Exposure Draft of Proposed International Valuation Application

## Mass Appraisal of Real Property

### 1.0 Introduction

- 1.1 The objective of this Application is to provide a reliable and consistent framework for the performance of mass appraisal assignments throughout IVSC Member States. The Application will also be of assistance in the design and implementation of mass appraisal systems.
- 1.2 The mass appraisal process is typically utilised for statistical or economic studies under government or semi-government administrative programs or as a basis for *ad valorem* property taxation. Mass appraisal data may also be used to determine the distribution of financial benefits or grants to government or semi-government authorities. This data should be available for revenue equalization purposes (see para. 2.1).
- 1.3 This Application applies to all mass appraisals regardless of the purpose or use of such valuations. Direction is provided on the substantive aspects of developing and communicating competent analysis, opinions, and conclusions in the mass appraisal of real property. Mass appraisals can be prepared with or without computer assistance. This Application includes instruction on the most common use of mass appraisal, that for *ad valorem* property taxation.
- 1.4 Property taxation has been practiced over the millenniums, and in most States remains a common means of raising revenue to meet the expenses of public sector entities and the services they provide. Addendum A provides an overview of property taxation and its present-day application around the world.
- 1.5 For a property taxation system to be effective, the following must be in place:
  - (a) a legal system and legal infrastructure that defines, supports and protects property rights;
  - (b) a recording and inventory system for all land, which represents the basis of taxation;
  - (c) sufficient market data from which valuations may be determined;
  - (d) sufficient resources and trained personnel to implement the system;
  - (e) continued maintenance of the inventory and data bases to ensure more refined data, more accurate valuations, and more equitable taxation.
- 1.6 The *mass appraisal* process includes:
  - (a) identifying properties to be appraised;

- (b) defining the market area in terms of consistent behaviour on the part of property owners and would-be purchasers;
  - (c) identifying characteristic supply and demand that affect the creation of value in that market area;
  - (d) developing a model structure that reflects the relationship among the characteristics affecting value in the market area;
  - (e) calibrating the model structure to determine the contribution of the individual property features affecting value;
  - (f) applying the conclusions reflected in the model to the characteristics of the property(ies) being appraised;
  - (g) reviewing the mass appraisal results.
- 1.7 The valuation basis for mass appraisal is *Market Value* as defined in *IVS 1, Section 3*, subject to any modification of the concept as defined under specific instructions or legislation.
- 1.8 Computerised methodology has made the mass appraisal process more efficient and more widespread, but has not altered that process. Data banks and computerised applications are used in data storage, mapping, data analysis, and testing of the analytical results.
- 1.9 While local legal requirements will take precedence, observance of the IVS Code of Conduct is, nonetheless, incumbent upon assessment/rating personnel, who carry out mass appraisals. The concept of *Market Value* is recognised as the assessment basis in most jurisdictions. The requirements of the IVS Code of Conduct necessarily supplement those of local law. Requirements under the Code of Conduct apply to:
- (a) the mass valuation process itself, and
  - (b) the use of computers and computer-generated models in the mass appraisal process.
- 1.10 The study area, or total area covered by a mass appraisal assignment, may be selected from geographical localities, land use categories, or areas subject to property taxes under state, county or local government areas prescribed by the relevant legislative or administrative authority of IVSC Member States.
- 1.11 Under typical administrative arrangements, mass appraisal may be undertaken by the “in house” staff of various authorities. There is also a worldwide trend towards outsourcing of mass appraisal services. Contracting entities may be allowed access to land data banks and other recorded information in possession of the instructing authority.
- 1.12 Mass appraisal techniques depend upon the extent and quality of land data available. This information may be quantitative (e.g., land areas, dimensions, building types, accommodation and fittings) or qualitative (e.g., assessment of physical condition, character, or market desirability of structural improvements and classification of sub-market groupings).

- 1.13 The selection of mass appraisal methodology shall be consistent with the type and quality of recorded information. Methodologies available include the *cost approach*; the *sales comparison* approach, and the *income capitalisation* approach as set out in *Section 2.7* of the *Property Types* section of the International Valuation Standards. Mass appraisal methodologies are consistent with generally accepted valuation principles (GAVP) stipulated elsewhere in this document. Under mass appraisal programs, these fundamental processes may be facilitated by computer-assisted methodology including, but not limited to, *linear regression, non-linear regression, multiple regression and adaptive estimation*.

## **2.0 Scope**

- 2.1 The various outputs from mass appraisal programs have financial implications in government and semi-government administration. For purposes of revenue raising, equalisation or distribution of revenue, any departure from an accurate basis of assessment will bring about an inequitable result. Local statutes prescribe the basis and definitions of values to be returned or output of mass appraisal assignments, the administrative procedures for the collection and delivery of valuation data, and processes for appeal of assessments.
- 2.1.1 The professional responsibility of Valuers is, in most instances, prescribed by statute or regulations affecting mass appraisal assignments. It is the professional duty of the Valuer to be familiar with, adhere to, and administer the provisions of any enabling legislation.
- 2.2 Among IVSC Member States there will be variations in statutory and administrative procedures where mass appraisal techniques are prescribed. Despite these differences, there are many common characteristics of mass appraisal programs in current usage. This Valuation Application defines the principles to be observed subject to express administrative instructions or statutory provisions to the contrary.
- 2.3 In all IVSC Member States, it is recognised that mass appraisal requires special education, training, and experience. The emergence of professional valuation societies at the national level attests to a market need for competent and highly ethical Valuers within each country. The globalisation of property markets and the establishment of IVSC Standards reflect market insistence that Valuers adopt consistent methods throughout the world. This Application provides a framework for understanding recognised methods of mass appraisal.
- 2.3.1 The appraisal profession is constantly reviewing and revising appraisal methods and techniques and devising new methodologies to meet new circumstances. For this reason, it is not sufficient for Valuers to simply maintain skills and the knowledge they possess when they become Valuers. Each Valuer must continuously improve his or her skills to remain proficient in mass appraisal.
- 2.4 In developing a mass appraisal, a Valuer must be aware of, understand, and correctly employ recognised methods and techniques necessary to produce and communicate credible mass appraisal outputs. Mass appraisal provides for a systematic approach and uniform application of appraisal methods and techniques to obtain estimates of value that allow for statistical review and analysis of results.

- 2.5 Mass appraisal procedures should observe standards of appraisal levels and uniformity of valuations to be returned under the program. The completed valuation data shall be presented in formats whereby the accuracy of existing and subsequent sales information can be demonstrated.
- 2.6 Mass appraisal assignments often apply to the unencumbered value of property, that is, the hypothetical fee simple estate in land. Under these circumstances, all subsequent interests such as leasehold and reversionary interests are excluded. This is a necessary administrative practice due to the very complicated and time-consuming process of establishing the value of fractional interests in land.
- 2.7 Mass appraisal systems are typically utilised by appraisal authorities that have statutory powers for discovery and collection of valuation data. The recording of data has evolved from manual methods to sophisticated data banks that facilitate computer-assisted appraisal, often incorporating geographic information systems (GIS). The statutory process will usually involve other government agencies in provision of qualitative and quantitative information essential to the process.
- 2.8 Statutory assessments normally apply for stipulated timeframes before a subsequent mass appraisal of the local area is again undertaken. Within this timeframe, the system must be capable of recording or making adjustments to assessment lists having regard to alterations in property characteristics, the level of values, and consistency of assessments.

### **3.0 Definitions**

- 3.1 *Ad Valorem Property Taxation.* A revenue-raising procedure, based on the assessed value of property related to a scale of charges defined by statute within a specified timeframe.
- 3.2 *Annual Value of the Income Stream.* The gross annual income, which, at the time of valuation, the fee simple owner of the land and its appurtenances, free from any encumbrances and restrictions on its disposal, might reasonably expect to obtain by leasing/letting it to a tenant on reasonable terms and conditions. Also called *rental value*.
- 3.3 *Assessment List.* A list of individual property values produced by an assessment authority for the purpose of *ad valorem* property taxation or statistical or economic studies.
- 3.4 *Improvements.* All work done or material used on the land by the expenditure of capital on, or for the benefit of, the land, but only so far as:
- (a) the effect of the work done or material used is to increase the value of the land and
  - (b) the benefit of the work is unexhausted at the time of valuation.
- 3.5 *Improved Value.* The capital sum which land, held by an owner in fee simple, free from any encumbrances and restrictions on its disposal, might be expected to realise if it were offered for sale on such reasonable terms and conditions as a *bona fide* seller would require.
- 3.6 *Land Value.* The capital sum, which the fee simple interest in the 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 any improvements on the land or appertaining to the land, other than site improvements considered as a component of land value, had not been made
- 3.7 *Linear Regression.* A process of statistical analysis used to investigate whether a dependent variable and set of one or more independent variables share a linear correlation and, if so, to predict the value of the dependent variable on the basis of the other variables.
- 3.8 *Multiple Regression.* A statistical technique, similar to correlation, used to analyse data in order to predict the value of one dependent variable, utilising the known values of multiple independent variables.
- 3.9 *Notice of Assessment.* An official notification of assessed valuations provided to owners or occupiers of real property under statutory provisions to facilitate the process of *ad valorem* property taxation
- 3.10 *Ratio Study.* A study of the relationship between appraised or assessed values and market values (prices). In mass appraisal, these are sometimes referred to as appraised value-to-sales ratio studies.
- 3.11 *Rental Value.* An alternative term for *Annual Value of the Income Stream* as defined above.
- 3.12 *Regression.* A method that examines the relationship between one or more independent variables and a dependent variable and is used to identify and weight analytical factors in making forecasts.
- 3.13 *Redundant Improvements.* Work done or material used on improvements, the value of which is exhausted at the time of valuation; the cost of the removal of redundant improvements is a factor in determining *Land Value*.
- 3.14 *Site Improvements.* Improvements such as draining, excavation, filling, retaining walls, or other improvements, which are considered a component of land value.
- 3.15 *Unimproved Value.* A definition of Land Value, which excludes site improvements and represents the value of land in its original condition.

## **4.0 Relationship to Accounting Standards**

- 4.1 Mass appraisal does not fall under the governance of national or international accounting standards.
- 4.2 Many elements of mass appraisal practice are determined under statutory law or regulation, including the definition of values to be returned under mass appraisal programs.
- 4.3 Mass appraisal value definitions are artificially structured to provide reliable economic indicators and evidence of resource allocation (see IVS 2, para. 3.7).

- 4.4 The purpose of financial reporting of fixed assets is to disclose financial interests in the value of assets and asset classes held under the control of the reporting entity. Valuers should be aware that revaluation procedures for financial reporting purposes are unrelated to mass appraisal procedures.

## **5.0 Statement of Application**

### **5.1 Data Collection and System Recording**

- 5.1.1 Appraisal data banks are built around land tenure records in national, federal, state or local government jurisdictions that define property ownership or interests in land. Records of title deeds, transfer documents and sales information are generally available to the system on demand except when such records are confidential or laws otherwise preclude their release.**
- 5.1.2 Building plans and areas, construction materials, building costs, accommodation, room counts, records of structural improvements and demolitions can be recorded in digital format by the appropriate authorities and imported into other computerised records systems from the records of the associated authorities.
- 5.1.3 Property information includes records of zoning and development plans, planning approvals, heritage classifications, contamination listings, landslip and any processes imposed by legal or statutory authority, which may impact upon land use or development rights.
- 5.1.4 Other qualitative or quantitative property information gathered from field inspection and evaluation may be entered into the system. It is not always necessary that such information be encoded by professional staff. However, the accuracy of recorded property information is vital to computer assisted appraisal models. Available details of all tenancies, area of leasehold occupation, lease conditions, rental values and review clauses should be recorded.
- 5.1.5 Rural property, industrial property, specialised property and central business districts all have their own appraisal characteristics, which should be recorded in appropriate data sets.
- 5.1.6 Characteristics of the market that are relevant to the purpose and intended use of the mass appraisal should be recorded in the system including:**
- (a) location of the defined market area;**
  - (b) physical, legal, and economic attributes of the properties;**
  - (c) timeframe of market activity; and**
  - (d) property interests reflected in the market.**
- 5.1.7 Data collection procedures should include the development of standardized data collection forms, and training materials.

## 5.2 Appraisal Methodology

**5.2.1 The following requirements apply to the development of a mass appraisal. The Valuer should identify:**

- (a) the client and other intended users;**
- (b) the purpose and intended use of the appraisal; and**
- (c) the scope of work necessary to complete the assignment, including any special limiting conditions.**

**5.2.2 The scope of work should be consistent with:**

- (a) the expectations of participants in the market for the same or similar appraisal services; and**
- (b) the requirements of IVSC Standards, Guidance Notes and Applications for the same or a similar assignment.**

5.2.3 Constraints on the mass appraisal process must not limit the scope of work to a degree that compromises the credibility of the mass appraisal results.

5.2.4 The Valuer must have sound justifications to support the scope-of work decision as well as the decision to exclude any information or procedure that would appear relevant to the client, intended users or affected parties.

5.2.5 The Valuer shall not limit the extent of research or analysis to a degree that would impair the credibility of the resulting opinions and conclusions in the context of the intended use of the appraisal.

5.2.6 The Valuer should identify any extraordinary assumptions and hypothetical conditions needed to carry out the assignment.

An extraordinary assumption may be made only if:

- (a) it is required to properly develop credible opinions and conclusions;
- (b) the Valuer has a reasonable basis for making the extraordinary assumption as set forth in Valuation Reporting, para. 5.7.1 (IVS 2003);

- (c) use of the extraordinary assumption results in a credible analysis and;
- (d) the Valuer complies with the disclosure requirements set for extraordinary assumptions in Valuation Reporting, para. 5.7.1 (IVS 2003).

A hypothetical condition may be made only if:

- (a) use of the hypothetical condition is clearly required for legal purposes, for purposes of reasonable analysis, or for purposes of comparison; and
- (b) use of the hypothetical condition results in a credible analysis and the Valuer also complies with the disclosure requirements set for hypothetical conditions in Valuation Reporting (IVS 2003).

5.2.7 The effective date of the appraisal must be identified.

**5.2.8 The Valuer should define the value being developed. If, under reasonable terms and conditions, the value opinion to be developed is other than *Market Value*, the relevant basis of valuation must be disclosed.**

**5.2.9 The Valuer should identify the characteristics of the properties that are relevant to the purpose and intended use of the mass appraisal, including:**

- (a) the group of properties subject to similar market influence as the subject property;**
- (b) the appropriate market area and timeframe relative to the property being valued; and**
- (c) the location and physical, legal, and economic characteristics of comparable properties.**

5.2.10 Each individual property in the grouping must be identified, with the information relating to its identity stored or referenced in its property record.

**5.2.11 The Valuer should identify the characteristics of the market that are relevant to the purpose and intended use of the mass appraisal, including:**

- (a) location of the defined market area;**

- (b) physical, legal, and economic attributes of the properties;
- (c) timeframe of market activity; and
- (d) property interests reflected in the market.

**5.2.12 In appraising real property, the Valuer should:**

- (a) identify and analyse whether an appraised physical segment contributes *pro rata* to the value of the whole, and identify the appropriate market area and timeframe relative to the property being valued;
- (b) identify and consider any personal property, trade fixtures, or intangibles that are not real property but are included in the appraisal;
- (c) identify known easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of similar nature; and
- (d) identify and analyse whether an appraised fractional interest, physical segment, or partial holding contributes *pro rata* to the value of the whole.

5.2.13 The above requirements do not obligate the Valuer to value the whole when the subject of the appraisal is a fractional interest, physical segment, or a partial holding. However, if the value of the whole is not identified, the appraisal must clearly reflect that the value of the property being appraised cannot be used to develop the value opinion of the whole by mathematical extension.

### **5.3 Assessment Lists**

- 5.3.1 The details of Assessment Lists and return of mass appraisal data are enumerated in appraisal contracts or by administrative directive. There may be many variations depending upon the purpose of the mass appraisal.**
- 5.3.2 In the case of Assessment Lists for *ad valorem* property taxation, the return of data must be sufficient to ensure the continued operation and administration of the taxation system having regard to the statutory requirements.**
- 5.3.3 The following items may be included in the return of assessments, depending upon the type of mass appraisal assignment:

- (a) property description by area, dimensions, lot number or other reference;

- (b) ownership details;
- (c) assessment details of valuations, as defined;
- (d) date of assessment; and
- (e) date on which the assessments come into force.

## 5.4 Mass Appraisal Value Definitions

- 5.4.1 **The values to be determined by mass appraisal should be specified in every case by reference to value definitions. In the case of mass appraisal for *ad valorem* property taxation, the value definitions are a provision of local statutes.**
- 5.4.2 Throughout IVSC Member States, there will be a variety of value definitions, their characteristics being in accordance with economic needs or revenue raising capability.
- 5.4.3 Commonly applied value definitions are *land value*, *improved value*, and *annual value of the income stream*, each having its own potential to distribute or raise revenue.
- 5.4.4 Variations to the above value definitions include *unimproved value*, *site value*, *capital value*, *net annual value of the income stream*, *rental value*, *assessed value*, and other value concepts.
- 5.4.5 The above value definitions may be subject to special provisions relating to heritage property.
- 5.4.6 **The Valuer/appraiser/assessor must be entirely conversant in the valuation methodologies required under differing value definitions and the relationship of these methodologies to the market value concept as defined in IVS 1, Section 3.**

## 5.5 Notice of Assessment

- 5.5.1 **The statutory assessment process requires that affected property owners be served Notice of Assessment in a timely and enforceable format.**
- 5.5.2 Upon receipt of the Notice, a property owner may exercise a statutory right to appeal the assessment. This appeal can be filed via computerised technology, now a feature of mass appraisal systems.
- 5.5.3 The Notice of Assessment must extract pertinent details for the owner's information, including identification of ownership, property details such as lot numbers, title reference, area, dimensions, date and proclamation of assessment, as well as the assessments to apply for *ad valorem* or other property taxation purposes.

## 5.6 Maintaining Assessment Lists

**5.6.1 The system must be capable of recording and making adjustments or alterations to the Assessment Lists, having regard to the level of values and consistency of assessments. Notice of Assessment should likewise apprise owners of alterations to Assessment Lists. Appeal rights also apply to amended assessments.**

5.6.2 System design should facilitate the process of making necessary adjustments to the Assessment Lists. Property information necessitating these adjustments is often made available by responsible authorities.

5.6.3 Assessment Lists can be amended for any of the following reasons:

- (a) amendments to land area or dimensions;
- (b) construction, addition or removal of structures;
- (c) value adjustments for redundant improvements;
- (d) addition or removal of site improvements;
- (e) rezoning, or changes to development procedures;
- (f) acquisition or resumption/repossession of land;
- (g) physical changes to the land;
- (h) errors or omissions; and
- (i) changes in boundaries of the study area.

5.6.4 For detailed information on best practice in mass appraisal methodology and the application of statistically based mass appraisal models, practitioners should consult publications of the International Association of Assessing Officers (IAAO).

## 5.7 Appraisal Contracts

5.7.1 In mass appraisal administration, the trend has been for authorities to engage the services of professionally accredited contractors. The movement towards outsourcing has been driven by national policy to promote competition, and implemented in some States by government directive.

**5.7.2 Mass appraisal contracts generally contain many of the following terms and conditions:**

- (a) a description of the study area;**
- (b) requirements for inclusion in, or exclusion from, the Assessment List of property types;**

- (c) the contents of Assessment Reports to be provided;
- (d) a confidentiality agreement;
- (e) value definitions such as *land value*, *improved value* or *annual value*, or their many international variations and equivalents;
- (f) required appraisal methodologies such as the sales comparison approach, the cost approach (summation approach), income capitalisation, deprival value estimation (for public sector entities), and regression techniques and an explanation of how these methodologies apply to various property types;
- (g) the names of nominated staff to undertake the duties of supervision, and field inspections as well as any sub-contractors to be employed;
- (h) the level of inspection required for various property types;
- (i) a timeframe for progressive phasing and final submission of appraisal data;
- (j) penalty provisions for non-compliance;
- (k) termination provisions for non-compliance;
- (l) standardised data sets for the return of data in digital format;
- (m) requirements for ongoing maintenance of the Assessment List;
- (n) submission of subsequent sales information and statistical tests required for standards of accuracy and uniformity; and
- (o) contract price and progressive or lump sum payment arrangements upon submission of completed data.

## **5.8 Standards of Appraisal Level and Uniformity**

- 5.8.1 The mass appraisal process must ensure that standards of appraisal level and uniformity are observed in the interests of assessment equity.**
- 5.8.2 The term *appraisal level* relates to the proximity between assessments and actual prices.
- 5.8.3 The term *uniformity* is a measure of consistency in error ratios.
- 5.8.4 Proof of appraisal level and uniformity is gauged by statistical indicators in the modelling process and by comparison with subsequent sales data. It is implicit in mass appraisal that even when property-specified and calibrated mass appraisal models are used, some individual value estimates will not meet standards of reasonableness, consistency, and accuracy. Valuers engaged in mass appraisal

have a professional responsibility to ensure that on an overall basis, models produce value estimates that meet attainable standards. This responsibility requires Valuers to evaluate the performance of models, using techniques that may include but are not limited to, goodness-of-fit and model performance statistics (e.g., appraised value-to-sales ratio studies of hold-out samples [representative areas used in checking accuracy and uniformity]), or analysis of residuals).

- 5.8.5 Measurement of appraisal level and uniformity is subject to appropriate standards and independent audit.
- 5.8.6 Should appraisals be undertaken in times of rapidly rising or falling markets, the period for selection of sales prices should be adjusted accordingly. The degree of acceptable variation should reflect the volume and comparability of market evidence.
- 5.8.7 Measures of appraisal level and uniformity are subject to the following provisions:
  - (a) the comparable property sales or rentals should be investigated and must qualify as arm's-length transactions. Those discarded for non-compliance with market levels should be listed as part of the assessment procedure and reasons, given for their exclusion from the comparable data.
  - (b) the comparable sales or rentals shall be indicative of the level of assessments included in Assessment Lists.
- 5.8.8 Appraisal contracts or statutory provisions may stipulate statistical parameters within which mass appraisal assignments must be shown to conform to market evidence.
- 5.8.9 The level of appraisal is measured by one of three measures of central tendency:
  - (a) the Median – the middle ratio when ratios are arrayed in order of magnitude;
  - (b) the Mean – the average ratio, found by summing the ratios and dividing by the number of ratios;
  - (c) the Weighted Mean – formed by dividing the sum of all appraised values by the sum of all sales prices.
- 5.8.10 Uniformity is measured within groups and between groups of properties. Uniformity between groups is measured by comparing measures of appraisal level calculated for each group. Uniformity within groups is measured by one of the following:
  - (a) Range – the range is the difference between the lowest and highest ratios;

- (b) Average Absolute Deviation – the average difference between each ratio and the median ratio;
  - (c) Coefficient of Dispersion – the average absolute deviation, divided by the median ratio and multiplied by 100;
  - (d) Standard Deviation – the average difference between each ratio and the mean ratio when the differences are squared. The average difference is divided by the sample size less one and taking the square root of the result;
  - (e) Coefficient of Variation – the standard deviation expressed as a percentage;
  - (f) Price-Related Differential – a statistic for measuring assessment regressivity or progressivity and calculated by dividing the mean by the weighted mean ratio;
- 5.8.11 There is no single statistical indicator that provides absolute proof of appraisal level and uniformity. Users should become familiar with the above statistical applications before making informed judgements on the adequacy of completed mass appraisal assignments.
- 5.8.12 Publications available from the International Association of Assessing Officers (IAAO) should be referred to for technical instruction.

## 6.0 Disclosure Requirements

- 6.1 To facilitate acceptance of mass appraisal outputs by instructing authorities, the Valuer should disclose all information and reasoning leading to adoption of a particular appraisal methodology. Statutory or contractual provisions will often stipulate such disclosure, but in their absence, valuation methodology must always be disclosed.**
- 6.2 Selection of a particular appraisal methodology depends upon the homogeneity or heterogeneity of study areas and the availability of property attributes within the system to cope with accepted appraisal models. Adoption of the cost, market comparison, income approaches, or alternative regression models must always be explained.
- 6.3 Software applications utilised in mass appraisal assignments should be disclosed together with commentary on their suitability for acceptance by instructing entities.
- 6.4 Disclosure of valuation methodology must be included in the report format accompanying Assessment Lists.
- 6.5 Appraisal Reports should disclose staff allocations utilised in the mass appraisal assignments, including the qualifications and involvement of professional staff employed.
- 6.6 Documentation for a mass appraisal for *ad valorem* taxation may be in the form of (1) property records, (2) sales ratios and other statistical studies, (3) appraisal manuals and documentation, (4) market studies, (5) model building documentation, (6) regulations, (7) statutes, and (8) other acceptable forms.

## **7.0 Departure**

**7.1 Departure from the provisions of this Valuation Application should only result from the provisions of statutory provisions, administrative instructions, or the terms of appraisal contracts.**

7.2 A Valuer may enter into an agreement to perform an assignment in which the scope of work is at variance with the initial instructions, provided that prior to entering into such an agreement:

- (a) The Valuer has determined that the appraisal process to be performed is not so limited that the results of the assignment are no longer credible;
- (b) The Valuer has advised the client that the assignment calls for something less than, or different from the work required under the initial instructions and that the report will clearly identify and explain the departure; and
- (c) The client has agreed that the performance of a limited appraisal service would be appropriate, given the intended use.

7.3 Further discussion on Departure provisions is set out in section 6 of the International Valuation Standards Code of Conduct.

## **8.0 Effective Date**

8.1 This International Valuation Application became effective (date)

# ADDENDUM TO PROPOSED INTERNATIONAL VALUATION APPLICATION — MASS APPRAISAL OF REAL PROPERTY

## PROPERTY TAXATION AROUND THE WORLD

### A1.0 Introduction

A1.1 Contemporary tax structures represent a complex array of income, capital gains, and inheritance taxes, excise taxes such as valued added taxes (VAT) and goods and services taxes (GST), and other tax categories, including import duties and user and licensing fees.

A.1.1.1 Some taxes are collected by the federal or central government; others, by the state or provincial governments; and still others, by local or municipal governments. Income taxes may be collected at two or even three governmental levels.

A1.1.2 Revenue to the federal or central government may be transferred to the budgets of state or provincial governments. In turn, state or provincial revenues may be shared with local or municipal governments.

A1.2 In pre-industrial societies, taxation of the agrarian population was the primary revenue source.<sup>1</sup> Today, land and property taxes make up only a small percentage of the total revenue collected in a State. However, in all States, the property tax is an extremely important component of local or municipal revenue.<sup>2</sup>

### A2.0 Significance of Property Taxes to Local Government

A2.1 Property taxes provide local and municipal governments, school boards, and public service districts (e.g., water, sanitary or sewerage, irrigation districts) with a principal source of revenue. In most States, property taxes are levied at the level of the state or provincial, and local or municipal governments.

A2.2 In most States, the prerogative to tax property belongs to the state and local governments. A prominent example is the United States, where the Constitution (1787) prohibits the federal government from levying taxes on land. Property taxes based on local assessments are the main source of revenue for municipal, township and county governments, and the public services they provide, e.g., education, welfare, police and fire protection, hospitals, and infrastructure.

A2.3 Where States have such a system of power-sharing by the various levels of government, property taxation is reserved to the state and local governments. Notable examples include:

- the council rates on property in the United Kingdom, levied by municipal or county governments;
- the property tax (*taxe fonciere*) in France, collected by the councils of the local *communes* (*conseils municipaux*)(in France there are also taxes on real estate levied by the governments of the *regions* and *departments*);
- the land or real estate tax (*Grundsteuer* or *Realsteuer*) in Germany, representing a

- community or local government tax (*Gemeindesteuer*);
- the property tax in Italy (*imposta comunale sugli immobili*), levied by local governments (*comuni*);
- the property tax in Japan, collected by municipal and local governments;
- the property tax in Mexico (*impuesto sobre le propiedad*), which until 1983 remained the prerogative of the states but has since been levied solely by the municipalities;
- the urban property tax in Brazil (*impuesto predial e territorial urbano*), collected by municipal finance departments (in Brazil, the central government levies the rural property tax, *impuesto territorial rural*);
- the property tax in China, administered by the finance bureaus of the local governments;
- the land tax in Australia, collected by the state governments (with the exception of Queensland) and the municipal rates, collected by the municipal authorities (under municipal rating provisions of state legislation); and
- the real property tax levied in Canada by municipalities (as for example, in Alberta); more centrally administered Provinces and Territories, which are responsible for municipal management, have taken over the function of assessment.

### **A3.0 Features of Property Taxation**

A3.1 In most States, *Market Value* has become the basis of assessments/ratings. However, there may be a lack of uniformity among the specific value definitions that apply in various state and local governments.

A3.1.1 Variable tax rates are levied for different classifications of real property. Land is generally valued separately from buildings, and often tax rates for buildings are less than those for land.

A3.1.2 Where inequalities exist between tax districts, uniformity may be achieved by the use of equalisation factors.

A3.2 The application of mass appraisal techniques differs according to the State and the local governmental authority. Municipal assessment/rating bureaus in metropolitan areas tend to employ computerised methods, including automated cost summation, income capitalisation, matrix generation, and regression analyses.

### **A4.0 Other Property-Related Taxes**

A4.1 Taxation based on property is not just limited to direct property taxes. In the United States, many states collect a conveyance tax at the time a property is transferred to the new owner.

A4.2 In European countries, Value Added Taxes (VAT) and transfer taxes are also collected at the time land or new buildings are purchased. The VAT, which originated in France in 1954, has become widespread throughout the States of the European Union.

A4.2.1 Generally, the VAT is a tax levied by the central or the national government. In Germany, however, the VAT is a joint tax (*Gemeinschaftsteuer*) of the federal (*Bundes-*) and provincial (*Landes-*) governments.

A4.2.2 Most European States collect a transfer tax as well. Specific examples of VAT and property transfer taxes include:

- the VAT and property transfer tax in the United Kingdom;
- the *taxe sur la valeur ajout e* (VAT) and *droits de mutation* (transfer tax) in France;
- the *Mehrwertsteuer* (VAT) and *Grunderwerbsteuer* (transfer tax) in Germany (the transfer tax is levied by both the provincial (*Landes-*) and local (*Gemeinde-*) governments; and
- the *imposta sur valore aggiunto* (VAT) and two other taxes levied on property purchases in Italy, the *tassa di bollo* (stamp duty) and *imposta di registro* (registration tax).

A4.2.2.1 France has yet another tax related to real estate, the tax on occupancy (*taxe d habitation*).

A4.3 Japan has a property transfer tax and a consumption tax that applies to real estate (similar to a goods and services tax).

A4.4 Transfer taxes are also levied in Latin American countries.

A4.4.1 In Mexico, there is both an *impuesto sobre el valor a adido* (VAT), which is a federal tax levied at the general rate of 15% (land and residential property are exempt) and an *impuesto sobre transmisiones de bienes raices* (real estate transfer tax) collected by the states at 2%-3% of the market value of the property.

A4.4.2 In Brazil, the federal *imposto de transmissao de bens imoveis* (ITB) is levied at 2% of the market value of the property and is paid at the time the deed is registered.

A4.5 Both Australia and Canada have a federal goods and services tax (GST), similar to the VAT.

A4.5.1 In Australia, most property transactions are subject to the 10% GST, which was introduced in 2001. An exemption is given to commercial property, classified as a going concern and thus subject to other forms of taxation; other exemptions extend to owner-occupied property or are based on attributes of personal taxation.

A4.5.2 In Canada, the 7% GST, which was instituted in 1991, is collected upon new construction, but neither resale property nor land.

## **A5.0 Where Property Rights Are Being Redefined**

A5.1 In Russia and China, property rights have recently been redefined.<sup>3</sup> Assessments/ratings on property were not levied by the Communist regimes. The demise of Communist rule in Russia and the development of a private sector economy in China have made it essential to redefine the right to use property.

## FOOTNOTES

1. In pre-industrial societies, taxation took three forms: obligations such as military service or corvee labor; a capitation tax, paid in kind or money; and a land tax, also paid in land or money. Since the economy was based on agriculture, the payment of all revenue was ultimately tied to cultivation of the land. Capitation taxes depended on agricultural yields, and corvee labor was largely expended on projects related to agriculture (e.g., land clearing and maintaining irrigation canals).

Under the European feudal system, land was held by vassals (or lords) in fief from the king (the theoretical owner of all land), incumbent upon the rendering of mutual obligations. The economic foundation of feudalism was the manorial economy. Serfs (or peasants) worked the land of the manor and fulfilled certain feudal dues (e.g., corvee labor on the lord's land). In the later Middle Ages, centralising monarchies found other means of raising revenue: the capitation tax (late 14<sup>th</sup> century) and *tallage*, broadly defined as the royal prerogative to tax land holdings. This prerogative was first exercised by the kings of England in the 12<sup>th</sup> century and the kings of France in the 15<sup>th</sup> century.

In the Islamic States, the principal revenue source from the early 8<sup>th</sup> century into the early modern period was the *kharaj*, a tax on land and buildings. The *kharaj* was levied under the Umayyad and Abbasid Caliphs, who awarded land grants (*iqta*) to military commanders and civil servants along with oversight of the collection of revenue from the rural population (*ra iya*). The Ottoman, Safavid and Moghul Empires had similar land tenure and taxation systems. In China, the Ming and Qing (Ch'ing) dynasties adopted a "single whip" system of taxation, whereby the land tax, collected by the rural gentry, largely replaced corvee labor as the principal source of revenue.

Inequities in the levying of the land tax have, on occasion, provoked large-scale dissatisfaction. By the 18<sup>th</sup> century, the nobility, clergy, and bourgeoisie in France had all gained exemption from the land tax (*taille*), which fell exclusively upon the peasantry and remained a serious grievance until its abolition during the French Revolution (1789).

In some States, the imposition of the land tax has represented a measure taken to rationalise the fiscal system. In England, the land tax was introduced in 1690 (during the reign of William III) to replace *scutage* (a monetary payment that supplanted the military service obligation) and *tallage*, which had become a tax on demesne (crown) land and towns under royal charters. Subject to annual approval by Parliament during the 18<sup>th</sup> century, the land tax became permanent in 1798. A property and income tax, also adopted the same year, was later repealed (1833), but reintroduced in 1842.

Reforms of the Meiji Restoration in Japan (the period following the downfall of the Tokagawa Shogunate and the restoration of the Meiji Emperor in 1867) adopted a land tax to finance the costs of Japan's modernisation. In 1873, the central government confirmed Japanese peasants as the outright owners of the land they worked, and substituted fixed monetary taxes for the traditional percentages collected on agricultural yield.

In Russia, the land tax and household tax were abolished by the reforms of Tsar Peter, who imposed a capitation or "soul tax" upon the peasantry. The capitation tax remained Russia's principal source of revenue between 1718 and 1886.

2. The different ways of compiling statistics around the world make direct comparison impossible. Nevertheless, it may be instructive to cite several breakdowns. In the United States, property taxes make up 13.4% of the total revenue of state and municipal governments (*Statistical Abstract of the United States, 2001*, page 268). In the United Kingdom, the council tax accounts for 22% of total service expenditures (*Whitaker's Almanack, 2000*, page 610). In Germany, property taxes make up 16.3% of local government revenue (*Brockhaus, 1990*). In Canada, property taxes account for 55% of municipal revenues (Canadian Property Tax Association [CPTA], "Understanding Property Tax Policy").

The CPTA paper acknowledges that the property tax is not without its faults. Critics call it unfair because as a regressive tax, the property tax is unrelated to ability to pay and is unrelated to benefits received. It is also described as unsuitable because it supports services unrelated to property, and inadequate because it does not generate sufficient municipal revenue. The text of the CPTA paper was posted on the internet 20 February, 2001. The text is accessible at [www.cpta.org/farticles.shtml](http://www.cpta.org/farticles.shtml).

3. The Soviet government (1917-1991) subscribed to a Marxist theory of value that understood labor as the foundation of value. While levying no taxes on property, the Soviet government did collect revenue from the profits of state-owned enterprises, and relied heavily on a turnover tax (*nalog s oborota*), generally hidden in the price at which goods were sold to consumers. President Boris Yeltsin initiated privatisation in 1993 by encoding the right to private property in the new Constitution. Nevertheless, land has only been bought and sold sporadically, and most land still remains in the hands of the government, which leases long-term land-use rights to farmers, businesses, and other individuals.

In October 2001, over the opposition of the Communists in the Duma, President Vladimir Putin legalised the purchase and sale of non-agricultural land. (*Washington Post*, October 2001) The Russian government has also introduced a new tax code, reducing the number of taxes and creating a new division of taxes at federal, regional, and local levels. But the new code addresses neither the institutional structure for, nor principles of, property assessment. At present, three taxes apply to real estate in Russia: the land tax, the tax on property owned individually, and the tax on property owned corporately. (Kaganova, page 241) (Passage of a 13% flat income tax in 2000 resulted in recent increases in taxes collected by the federal government.)

China began the transition from central planning to a market economy in 1978. The 1982 Constitution declared all urban land to be owned by the State while land in rural areas was recognised as under the collective ownership of the people, who worked it. Plots of land, on which privately owned residential dwellings stand, are State property. Land-use rights in China are conferred by a leasehold system. The owners of residential dwellings enter into land-use agreements with the government. Private-sector commercial and industrial buildings are also developed on land under long-term (a maximum of 40 to 70 years) land-use agreements with the government. Upon expiration of these agreements, the land-use rights are surrendered to the government. Collectively owned agricultural land is leased to families for 30-year periods. In return, the agricultural workers turn over to the State a fixed part of their production at set prices (by law, the tax ceiling is fixed at 5%). They sell the remaining part of their production on the free market (UNESCO *Courier*, 2001).

Real estate in China is taxed on either at 1.2% of the property's net book value or at 12% of the rent the property generates. Residential and apartment buildings as well as buildings financed by the government (such as hospitals, schools, government administrative offices, parks, and temples) are exempt from property taxation. (In 2000, the government ended the practice of allocating living units in State-owned apartment buildings to State employees—the event has spawned a construction boom in apartment buildings.) Revenue bureaus of local governments administer real estate assessments/ratings. When the book value of a property is not available, its assessment is determined on the basis of comparison with the values of similar properties. (Chen Ming Hai, 7/23/02)