

Assessment of mass valuation methodology for compensation in the land reform process in Albania

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1. Introduction

Albania has been going through a series of land and property reforms since the early 1990s. The reforms have seen large scale land allocations in rural areas and the privatization of land and immovable property throughout the country. Over 80% of rural land has been allocated and registered, but in urban areas the percentage is much smaller. Albania has made very principal solutions to carry out valuation based on market values in the reform process. It is a remarkable step in context of property market that can be characterized by low activity and problematical transparency. Market transparency is first of all related to the human mentality, but not only. To make markets more transparent it is necessary to use also administrative tools. Reducing transfer costs, changing the system of notary fees, etc. can be mentioned as examples. They do not produce very rapid changes but progressive ideas have to be implemented, and they can produce results in the nearest future.

The system of valuation has to be fair and transparent but it is necessary not to produce any negative fiscal implication to the state budget. It is very important to follow the principle that valuation should be based on market value. It means that the valuation has to be as far from the politics as possible. In this context it is necessary to look very carefully to privatization which is based on state land reserve and still diminishes the area which can be used for physical compensation.

The privatization process was helped with the passage and implementation of three main substantive laws in 1991, 1992 and 1993. Those were the Laws On: Land; the Privatization of State Owned Housing; and the Restitution and Compensation to Ex-owners. The Constitution guarantees the right to private property and the Civil Code defines three types of ownership and regulates relationships and obligations among property owners. The *Law On Registration of Immovable Property* outlines the procedures for recording ownership of property and other real rights. Other laws passed between 1991 and the present day dealing with Expropriation and Compensation, pastures, forest, urban planning, irrigation, environment, valuation, State owned property, etc. are also relevant. In June 2004 a law *On Restitution and Compensation of Property* (hereafter referred as the LRCP) was passed. The objective of this law is to provide a solid legal base from which people that were unjustly deprived of their property in the past can regain their property or an equivalent in alternative property or money.

A fundamental requirement of the LRCP is to develop a valuation methodology and a procedure of valuing property:

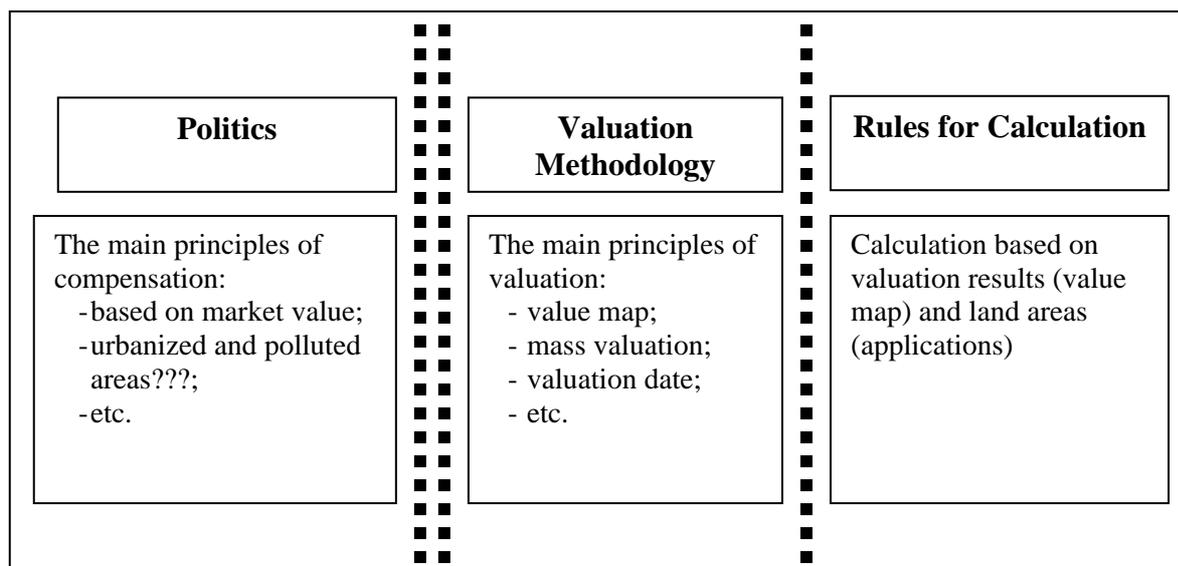
- that was expropriated (both with new structures since expropriation and without those structures, and
- is a current State asset that can be used for compensation.

A State Committee for Restitution and Compensation of Property has been established and twelve regional commissions have been established to oversee and implement the requirements of the LRCP. The State Committee for Restitution and Compensation of Property has prepared a valuation methodology assessment of which is the main task of the current report. This paper gives an analysis of existing valuation methodology and briefly handles also fiscal implications, procedures for dealing with applicants and the resources required to complete the requirements of the LRCP.

2. Assessment of Valuation Methodology

The methodology is based on law, which gives some main principles (first of all market value as the main basis of valuation). The existing methodology covers probably most valuation approaches, but difference between valuation methodology and calculation of compensation is not very clear. There are also some politically very sensitive questions. Politics cannot be a part of valuation and all political issues have to be decided outside of valuation. Partly it has to be done before valuation, speaking about fiscal impacts it can be good idea to find the final solutions when valuation is done already. It necessary to keep politics from valuation as far as possible, because otherwise there will arise some additional possibilities for corruption.

Figure 1. Relations between Politics, Valuation Methodology and Calculation of Compensation



2.1 Market Value as the Basis for Compensation

The existing methodology is simple to understand and probably easy to implement. As the methodology is based on Law 9235, dated 29.07.2004 “On Restitution and Compensation of Property”, the market value can be the only acceptable basis. There are only a few examples of countrywide mass valuation projects, which have carried out for some other purpose instead of taxation. Probably the land reform is and can be another remarkable reason to have such a comprehensive mass valuation project. The market value as a basis for compensation is probably the only basis, because the principle of equal treatment does not give any other possibilities. The market value is highly recommended and commonly used in context of property taxation for example.

Any compensation to the former owners is discussable, because most taxpayers today do not have any relation to the illegal expropriation of property many years ago. It can be sensitive if the compensation is relatively low compared to the market value: people who get the compensation are not satisfied. If compensation is above the market value it means an unjust decision from the point of view of the whole community, because taxpayers have to cover some extra expenses, which are the result of incorrect political decision and/or unprofessional work of valuers. Market value is not something especially important not only in context of compensation and restitution and in context of relations between the former owners who get compensated and the whole community. International Valuation Standards give the most well-known definition of market value: “*Market value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion. (IVS 2000)*”

2.2. The Lay-out of Existing Valuation Methodology

The existing valuation methodology covers not only valuation, but it is partly calculation based on valuation results and partly it is politics. Comparing three land categories of land (in general terms agricultural land, building sites and building sites in tourist zones) there are big differences between those categories within the context of valuation. The structure or even the logics of valuation is very different.

Valuation methodology of agricultural land is based on net incomes received from land cultivation. There are no figures about the basic value level in the existing methodology. Probably such kind of calculation has to be done in the process of valuation. Not speaking about the correctness of methodological approach behind of it, the idea to handle as a part of valuation is well grounded. There are the needed coefficients in the existing methodology and the use of coefficients in terms of system construction is a rational approach.

Valuation methodology of building sites is built up differently. There is only a methodological approach and general terms how the mass valuation project has to be done. In a very formal way the approach is the same compared to the agricultural land: there is the basic value which is corrected with coefficients. At the same time the approach is very different: it is location-based and there is no information about the values of coefficients. It means that analysis has to be done during the valuation process.

Valuation methodology of building sites in tourist zones is different again. We can find both the basic land value (accordingly 20 and 40 EUR per m² for the zones around the inland waters and seashore) and the values of coefficients from the methodology. It is a country-wide approach. Nevertheless from point of view of system construction it is very different compared to the methodology of agricultural land and building sites. The only thing to do is to calculate based on the location the value for a certain property.

Table 1. The existence of basic value and the value of coefficients in methodology

	Basic value	The value of coefficients
Agricultural land	No	Yes
Building sites	No	No
Building sites in tourist zones	Yes	Yes

All three land categories are based on different lay-out of methodology. The harmonization is not only a formal issue, because there is a real need to provide a tool which gives a fair solution not only within the category of land but the same principle has to be followed in context of relations between different categories of land. It seems logical that the methodology should give an answer how the analysis has to be done.

3. Land Valuation Methods

As compensation is primarily related to the land the methods of land valuation have to be handled. It is discussable but it is typical to point out 6 different methods of land valuation. These approaches are: (i) sales comparison; (ii) ground rent capitalization; (iii) cost of development; (iv) allocation; (v) extraction and (vi) land residual.

The sales comparison is probably the best way to estimate the land value, but sometimes there is a lack of sales data or problems with reliability of this information and sales comparison approach is impossible to use. Sales comparison and ground rent capitalization are two of three “classical” approaches. All the other approaches, i.e. cost of development, allocation, extraction and land residual methods, are combined based on three main approaches. Those methods are also known as residual methods.

Methodological background for different land categories is different. Not very clearly, but mainly valuation of agricultural land is based on income approach, valuation of building sites is based on allocation method and valuation of building sites in tourist zones has probably the same idea with valuation of building sites but it is applied completely differently.

4. The Essence of Existing Valuation Methodology

The essence of valuation methodology for different land categories is rather different. Some basis of basic value and coefficients can be found from the table below.

Table 2. The basis of basic value and coefficients in methodology

	The basic value based on:	Coefficients for correction of:
Agricultural land	Agricultural production	Location and some other factors (as irrigation)
Building sites	Location	Bundle of rights (mainly)
Building sites in tourist zones	Country-wide (minimum) value	Location (mainly)

The methodology of agricultural land is based on agricultural production, which cannot be handled as a land valuation approach. The method itself is correct and probably it is based on acceptable principles and theoretically has to be useful but the problems arise on practical side. The value of agricultural land is defined from these criteria:

- a. Category of agricultural land,
- b. Corps structure,
- c. Production of agricultural plants,
- ç. Valuation of net price per unit of the agricultural land,
- d. Potential price for the land according to the capitalization of the net profit value.

This approach is clearly based on potential production of agriculture. The value based on potential production does not correspond to the market value. If there is no demand or

demand is very limited (sometimes and probably quite often it means that supply is also limited) the number of transactions is limited and the price level is also relatively low. It is mainly affected by the macro and micro level location, the influence of soil quality (fertility) is not so important. Sometimes soil fertility has clear correlation with some factors of location, because human settlements are situated based on it. It is very simple to make “mistakes” in calculation because the final result is very sensitive to the outgoings (expenses) and even small changes in outgoings can affect dramatically the final results. The potential value of agricultural land, calculated according to the criteria, is corrected with the following coefficients: (i) water coefficient, (ii) coefficients for the distances from the urban centers and processing industries, (iii) development coefficient, (iv) coefficient of land use.

Subsequently, on the basis of the mass land valuation for physical and monetary compensation stands the compared price of sales in the determined area. The market value for a certain zone shall be calculated on reliable market sales information. The average of the prices realized in the zone, according to the categories of land, shall consist of the price to be used for the surfaces to be compensated and those that will be used for compensation. The above principle shall be applicable in all those cases where the land market is existent, real, non-deformed and formal.

$$Price = (\sum price\ of\ a+b+c+d\dots+n)/n$$

Where a, b, c ... n: lots/parcels or zones with realized prices.

The formula above describes an ideal zone which is really homogeneous and which is covered with relatively typical sales. To take into account deviations affected by differences in elements of comparison (property rights, conditions of sale, market conditions, location, etc) it is allowed to use adjustments including time adjustments.

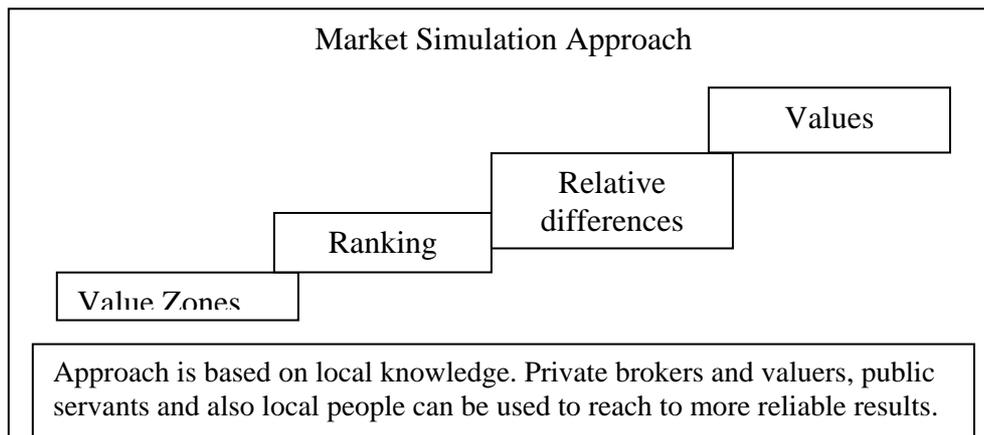
In an area where there is no functioning market shall be used the indirect valuation method based on relative comparison of land use and productivity information, socio-economic information, etc. Techniques of market simulation and interpolation shall be used to take into account relative differences between different zones. The principle of this methodology consists of the calculation of the annual profit of the land. Based on the profit the relative differences in land values can be calculated through the capitalization of the profit. Alternative approaches to estimate the relative differences are based on capitalization of land rent and on estimation of the share of uncultivated land in certain zone. Information concerning socio-economic and demographic situation (the rate of unemployment, age of population, etc.) shall be used to carry out macro-level analysis. To calculate the profit it is necessary to find out first the productivity, the cost for its realization, the revenue taken from the production per surface unit, profit and then its capitalization. The methodology contains some calculations and study stages detailed as follows:

$$Price = [(100 * net\ profit) / \% \ of\ banking\ interest] * [C_{f. Gr.}] * [C_{water}] * [C_{distance}] * [C_{develop.}] * [C_{exploitation}]$$

Based on the formula above, there were some calculations made by the working group. According to their results the basic value of arable land is 0.8-3.5 EUR/sqm (8000- 35 000 EUR/hectare). This information does not give any clear idea about the values and there is some kind contradiction between different land values. It is not correct to speak about too high values which are estimated using the existing methodology because there is no comprehensive database for comparison. At the same time there is something questionable in the current methodology. The only way to make it clear is to analyze the real prices and some indirect market information like the number of sales and percentage of uncultivated land in the region, even rental market can be handled as an indirect market information, because in

some region it is possible to agree about some limited payment, in some regions it is more or less based on agreement without any payment. The main problem is related to low activity of market and unreliability of market information. Both are problems, but the market of agricultural land is non-active in many countries. The reliability of market information is a bigger problem. At the same time it is possible to get some sales information from the Registration Office and the brokers have information about real prices. This basic value level can be corrected based on factors like soil fertility, irrigation, etc.

Figure 2



Market simulation approach can be used as an alternative approach to the direct comparison. If there are comparable sales only in certain areas, the rest of areas can be covered using the market simulation approach. The idea of this approach starts from composing value zones (areas, where there are similar value level and the same factors of value), it continues with ranking and relative differences (%) and finally it is possible to find the absolute values using value levels from some other zones (the zones where comparable sales really exist).

5. The Current Land Market Situation in Albania

The market situation in Albania can be characterized with the following:

- the market is not transparent and market information is unreliable;
- the market exists mainly on urbanized areas, land in rural areas is very rarely sold;
- the market is concentrated to the capital area and attractive regions on the sea-shore;
- the market is still partly illegal, properties are sometimes sold by persons without any legal rights to the property and/ or without registration.

There are different reasons, why the market is undeveloped. It is mainly because of historical reasons. Today it is necessary to add the land reform, which is not completed yet and from point of view of market it means that not all land units are registered so far. In many cases there is no real reason to make illegal deals. So, it is also a question about information delivering and willingness to be loyal and to follow the existing laws. High transfer costs can be mentioned as a reason not to declare the real price. It can be one of the reasons that first at all it cannot be the main reason.

As market transparency and development are the problems from point of view of valuation it has to be handled in more details. It is clear that to turn the market to the "right" direction is impossible in time period, which can be use some-how important from point of view of

valuation for compensation purposes. It means that the only possibility in context of current valuation is to study and analyze the existing property market as much as possible. Transaction costs can be reduced and people can be better informed, but the main thing is market functioning itself. It concerns especially the development of mortgage financing. In Baltic countries the property market became more active after mortgage financing became common. At the same time it is really complicated issue and it is related to the development of domestic economy and whole society.

6. Conclusions

The existing valuation methodology was a big step to the direction of market value based compensation to the former owners. However, there were some weaknesses in context of market value in the existing methodology. The existing methodology needed improvements to reach as close as possible to the market value. It concerned especially valuation of agricultural land, but in certain part of valuation building sites in tourist zones as well.

Well-functioning and market-based valuation system is first of all a basis for a fair compensation to the former owners, but at the same time it is a part of reforms and progressive development in wider context. The Albanian Government and donors must commit resources to achieve to the successful results.