

Analysis of an Alternative Mode to Derive Annual Value in Sri Lanka: A Case Study of the Gampaha District

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Abstract

The existing rating assessment system adopted by local authorities requires considerable staff and time, and is generally perceived as complex, with a significant number of rating re-assessments remaining outstanding. To address these issues, the *Contractor's Test Method*–embedded valuation model was proposed and tested using a stratified random sample across 19 local authorities in the Gampaha District. The findings revealed that 61% of the sample showed a difference of less than $\pm 10\%$ in annual value compared with existing assessments. The average difference in total annual values at the local authority level was $\pm 4\%$. In addition, the proposed method achieved a time saving of approximately five minutes per property, further it was capable of generating both capital and rental values. Overall, the results indicate that the proposed assessment method addresses several shortcomings of the existing system to a significant extent.

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Introduction

Assessment tax is a key component of the income generated by local authorities. The rating tax system was introduced during British colonial rule under the Municipal Council Ordinance of 1865 and over time, the system expanded with the establishment of Urban Councils and Pradeshiya Sabhas. The Department of Government Valuation (DGV) is the main authority that estimate the annual value for local government taxation purposes. This annual value serves as the tax base as defined in relevant Acts and Ordinances. The comparable method is primarily used to assess the annual value, while the contractor's test method and the profit method are applied in appropriate.

As of the Department of Government Valuation's 2019 annual report, 2,865,290 hereditaments were reported as pending assessment (GVD 2019). Many local authorities have not conducted revaluations for over considerable time period. Additionally, newly developed areas, new properties, and new revaluation requests continue to increase the backlog each year. The 1999 Commission of Inquiry on Local Government Reform noted that the existing rating system was complicated, cumbersome, and understood by ratepayers (Wasantha *et al.* 2017). Senaratne (2018) found that the existing mode of assessment required more time and staff. base on fact, it is evident that an **alternative assessment mode** is necessary to address both current inefficiencies and future demands in the rating assessment field.

Objectives

01. To identify the issues and limitations in the current rating assessment system

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02. To proposed alternative mode for deriving the annual value of hereditaments.
03. To analyze the advantages and disadvantages of the propose mode

Literature Review

The unit of assessment is hereditament that is means property which is or may become liable to a rate being a unit of such property which is, or would fall to be shown as a separate item in the valuation list (Section 115 Rating Act, 1967). It is common practicing to say that a property is rated but as in the word of Lord Russell “the occupier, not the land is ratable but the occupier is ratable in respect of the land he occupies. (Westminster council Vs The southern railway co.ltd, 1936)

Section 230 in MC and Section 160 of UC ordinance and Section 130 of PS Act was defined the taxable area and hereditaments. The annual value is defined in Section 327 of MC Ordinance, Section 249 of UC Ordinance and Section 226 of Ps Act. The definitions are more similar, the definition of the annual value in the Section 226 in PS Act is as “Annual Value” means the annual rent which a tenant might reasonably be expected, taking one year with another, to pay for any house, building, land, or tenement if the tenant undertook to pay all public rates and taxes, and if the land lord undertook to bear the cost of insurance, repairs, maintenance and upkeep, if any, necessary to maintain the house, building, land or tenement in a state to command that rent”.

As per Roger *et al.* (1984), the basis of assessment tax thus came to be the value of the land occupied. The tax base should represent the benefit of serves provide by the local authorities whereas the Capital value, annual value and land value are representing the value of the services provided by the local authorities. Capital value, Net annual value, Unimproved value and Annual value are main bases of assessment tax calculation in the countries. The annual value is the tax base in Sri Lanka as define in the legal enactments.

Although there are various methods of valuation, it appears there are only three methods that usually appear to be generally adopted in many States (Atilola *et al.* 2016). The mostly adopted methods for annual value assessment are comparable method, Contractors test method and profit method. Rental method is commonly applied because it complies with the legal definition of annual value.

Even though contractors test method of valuation has been referred to in the Land Tribunal number of occasions as a “method of last resort” (Roger *et al.* 1987), RICS (2017) point out that used as a last resort note that there is no statutory provision as to the circumstances or the classes to which the Contractor's basis of valuation is to be applied. In further RICS professional standard and guidelines describe that “if the Contractor's basis is properly applied in accordance with the guidance note, by valuers using appropriate professional judgment, it is an acceptable method of ascertaining the value of properties that cannot be satisfactorily valued by other means

Methods

The Contractor's Test Method was selected as a base for an alternative mode, based on an in-depth review of the literature, current challenges in the assessment system, the advantages of the method, and the prevailing conditions of the rental market in Sri Lanka. It aligns well with the principles of fairness, objectivity, and transparency key elements lacking in the existing system.

$$\text{Annual Value} = (\text{Land Value} + \text{Effective Capital Value}) \times \text{Decapitalization Rate} + 10\% (\text{cost of insurance, repairs, maintenance and upkeep})$$

Where,

Annual Value -Annual rent as defined in respective legal enactments

Land value- Land extent multiply by appropriate market rate approved by government chief valuer




Effective Capital value- Replacement cost (as approved by chief valuer) of developments adjusted for the obsolescence

Decapitalization rate – Appropriate yield rate (approved by chief valuer) divided by 100

The above formula was used as the foundation for developing an alternative mode of rating valuation. To operationalize the new method, a Rating Valuation Sheet was developed. This sheet provides a standardized and transparent structure for calculating the annual value of a property using the proposed mode.

Figure 01

Proposed Rating Valuation Sheet

Rating Valuation sheet									
Asst	Type of used	Land Value		Building value			Decapitalization	Adjustment	Annual Value
No.		Extent	Approved Value for land	floor area	Approved replacement	Adjustment for			
		Perch	Rs.	Sqft	cost per Sqft	obsolescence	rate	for M,R,I %	Rs.
1	Residential	12.5	100,000	3000	3500	0.8	0.04	0.10	
			1,250,000.00			8,400,000.00			
					MV	9,650,000.00	386,000.00	38,600.00	424,600.00
	Building Image								
	Access road			Front view			Inner view		
									

Source: compile by Author 2020

This study was conducted with a special focus on the Gampaha District. The district comprises 2 MC, 5 UC and 12 PS. the estimated total number of hereditaments within all local authorities in the district was 867,606. This figure was considered as the population size for the study. To determine an appropriate sample size, the Creative Research Systems Sample Size Calculator (2020) was used. The sample was calculated based on a 95% confidence level with a confidence interval (margin of error) of 7.11.

Figure 02

Estimating Sample Size

Determine Sample Size

Confidence Level: ☒ 95% ☐ 99%

Confidence Interval:

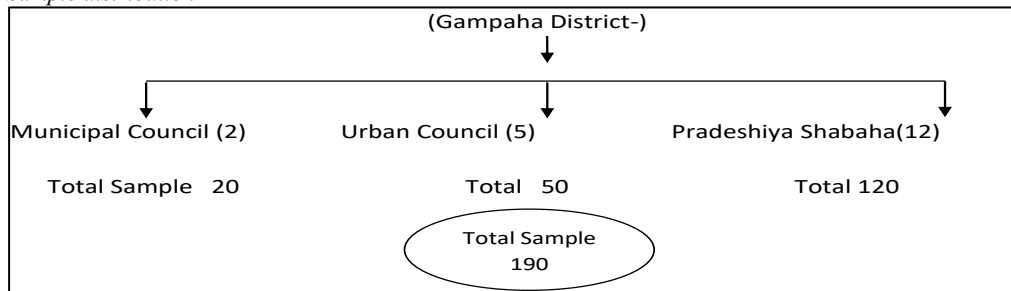
Population:

Sample size needed:

Source: <https://www.surveysystem.com/index.htm>

There were 34 valuation officers assigned to handle assessment valuation tasks in the Gampaha District. Out of this group, 20 valuation officers were randomly selected to collect data for Objective 01. For Objectives 02 and 03, a stratified random sampling method was employed, A total of 190 hereditaments were selected. This distribution is illustrated in Figure 03. For Question No. 4, data was specifically collected from valuation officers who were involved in the sample survey. A total of 10 officers contributed to the data collection process and completed this question. In the case of Question No. 5, data was collected from randomly selected ratepayers, with a target of 3 ratepayers per local authority. While 57 ratepayers were initially selected..

Figure 03
Sample distribution



Source- Compile by Author 2020

Methodology

The research methodology of this study was designed to achieve the stated objectives through a combination of qualitative and quantitative approaches. Initially, a comprehensive literature review was conducted to identify the key issues in the existing rating assessment system. This was followed by a questionnaire survey administered to 34 randomly selected valuation officers in order to validate the issues identified and to gather empirical data. The proposed assessment model was then tested for suitability by comparing the proposed annual values with the existing annual values. Furthermore, specific questionnaire items (1, 2, 4, and 5) were analyzed using random sampling techniques to evaluate the applicability of the model in practice. The findings from both primary and secondary data were synthesized to develop recommendations aimed at enhancing the effectiveness and efficiency of the rating assessment system.

Results and Discussion

Objective 01- was designed to identify and confirm the issues challengers of the current rating valuation system. While several challenges were recognized through the literature review, a sample survey was conducted to validate and prioritize these issues based on practitioner insights.






The survey responses revealed the following as the major issues, listed in descending order of frequency of responses:

1. The assessment method requires more staff
2. The rating assessment process is time-consuming
3. The assessment process is complicated
4. The method is difficult for ratepayers to understand

Although lack of transparency in the rating assessment system was highlighted in the literature, 75% of survey respondents disagreed with this concern. Hence, it can be concluded that transparency is not perceived as a major issue by the valuation officers involved in the sample survey.

These findings emphasize the need for a more efficient, streamlined, and user-friendly valuation method, supporting the development of the alternative model discussed in earlier sections.

Table 02*Sample survey results - Issue and challengers*

Q.N	The present rating system (Rating Card/Filed book) is having following issue	Strongly agree	Agree	Disagree	No idea	Agreed
1	More time consuming for the rating assessment process	25%	75%	0%	0%	100% 
2	The assessment method required more staff	50%	50%	0%	0%	100% 
3	Lack of transparency of rating assessment system	0%	25%	75%	0%	25% 75% 
4	Assessment process is Complicated	10%	60%	30%	0%	70% 30% 
5	Assessment method is hard to identify to the rate payers	20%	30%	0%	50%	50% 50% 

Source- compile by Author 2020

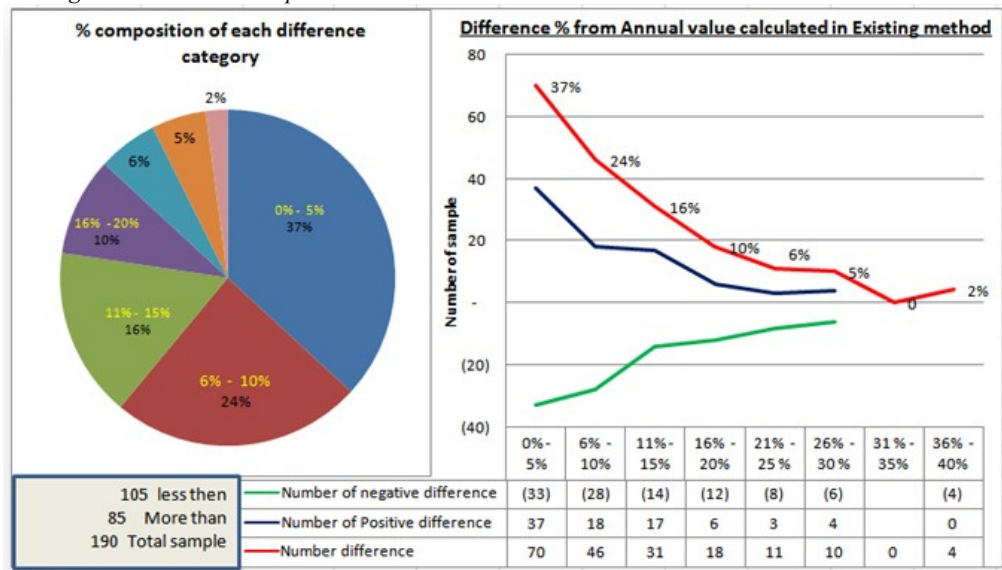
Objective 02 - To proposed alternative mode for deriving the annual value of hereditaments.**Table 03-***Sample survey results- propose rating mode*

Sample ID			Method	Annual value Rs.		Difference (EM-PM)	Difference %
Local Authority	Road	Serial number		Proposed method (PM)	Exiting Method (EM)		
NMC	KM	1	PM	783,043.2		16,572	2%
			EM		799,615		
NMC	KM	2	PM	617,734.1		74,574	11%
			EM		692,308		
NMC	KM	3	PM	328,430.4		(34,091)	-12%
			EM		294,340		
NMC	KM	4	PM	780,155.8		114,652	13%
			EM		894,808		
NMC	KM	5	PM	186,144.5		(18,541)	-11%
			EM		167,604		

Source- compile by Author 2020

The comparison between the proposed Contractor's Method-based mode and the existing annual values revealed encouraging results.

- 61% of the sample population exhibited a difference of less than $\pm 10\%$ between the annual values calculated by the proposed mode and the existing annual values.
- The absolute mean difference percentage across the sample was $\pm 10.11\%$, reflecting the overall variance in individual assessments.
- The absolute average difference in total annual value per local authority was $\pm 4\%$.

Figure 04*Existing Annual value Vs Proposed Annual value*

Source- compile by Author 2020

- The total difference in annual value across all local authorities was -1%,

Table 04*Total difference in Annual Value calculation*

Local Authority code	Total Annual value Rs.		Difference (EM-PM)	Difference %
	Existing Method (EM)	Proposed method-(PM)		
NMC	4,241,255	4,490,092	(248,837)	-6%
GMC	3,471,702	3,336,431	135,272	4%
JUC	2,875,040	2,769,754	105,286	4%
PUC	3,416,275	3,483,338	(67,063)	-2%
MUC	2,071,615	2,009,421	62,195	3%
WUC	3,550,558	3,472,340	78,218	2%
KUC	2,256,346	2,218,351	37,995	2%
GPS	1,899,587	2,086,426	(186,839)	-10%
JPS	1,856,652	1,918,625	(61,974)	-3%
WPS	1,914,842	2,110,638	(195,796)	-10%
APS	1,787,239	1,694,872	92,367	5%
KPS	1,670,895	1,705,421	(34,526)	-2%
BPS	1,542,799	1,555,876	(13,077)	-1%
DPS	1,506,162	1,446,887	59,274	4%
MPS	1,914,842	2,098,641	(183,799)	-10%
DiPS	1,787,239	1,677,522	109,717	6%
MaPS	1,690,787	1,700,219	(9,432)	-1%
KePS	1,542,799	1,526,146	16,653	1%
MiPS	1,369,915	1,379,582	(9,666)	-1%
Total	42,366,551	42,680,582	(314,031)	-1%

Source- compile by Author 2020

Suggesting that, in aggregate, the proposed method is closely aligned with the current assessment outcomes. These indicators demonstrate that the proposed mode produces results within an acceptable margin of variation.

Objective 03 - To analyze the advantages and disadvantages of the propose mode

Advantages of the Proposed Rating Assessment Mode

1. Time Efficiency-The proposed mode is significantly more time-saving compared to the existing rating valuation method.
2. Reduced Staffing Requirements-Fewer valuation officers are required to carry out assessments under the proposed mode, making it more resource-efficient.

Table 05

Time calculation of Existing and proposed method

Sample	Proposed mode		Exiting mode	
	Field work	Office work	Field work	Office work
Total time- (minutes) for (190 samples)	1250	499	1870	880
Minutes Per units – each work	6.58	2.63	9.84	4.63
Minutes Per units	9.21		14.47	
Time saving -Minutes	5.27			

Source- compile by Author 2020

3. Calculation simplicity of proposed mode -(data collected from 10 number valuation officers who directly contribute to the valuation calculation in objective two) ease

Table 06

Sample survey of use of easiness if each method

Calculation of annual value by this method is Simple –(Response by valuation officer)				
Mode	Strongly agree	agree	disagree	no idea
PM	0	10	0	0
EM	0	0	0	0

Source- compile by Author 2020

4. Improved Understanding by Ratepayers.

Table 06

Sample survey of rate payers responds

The system of tax calculation is understood - response by rates payer					total - Agreed	% of sample population
method	Strongly agree	Agree	Disagree	No idea		

PM	7	38	0	9	45	83%
EM	0	35	10	9	35	65%

Source- compile by Author 2020

5. The data collected for rating assessments under the proposed mode can also be used for capital valuations purpose.
6. The process encourages valuers to engage more deeply with land and building values across localities, enhancing their field knowledge. The development of a comprehensive land and building value database, along with capital valuation experience, contributes to professional growth.
7. The established database can be utilized to assess property damage in critical situations such as tsunamis, earthquakes, or explosions. Since most of the data required for capital valuation is already gathered through the proposed process,

Disadvantages of the Proposed Rating Assessment Mode

01. Cost base method was considered as last resort for the tax assessment.
02. The annual value derived by the proposed mode was reported deviations with the existing annual value.
03. The proposed mode was not developed proper rental data base like in existing mode of rating assessment.

Limitation

01. The system to apportion of annual value for each unit in large shared property with several hereditaments was not tested by this method.
02. The proposed mode is not suitable if there is good rental market

Conclusion

Policymakers should focus on addressing the inefficiencies in the current rating valuation system. Reducing the time required for assessments could also help mitigate the issue of staff shortages. A dedicated committee should be appointed to further investigate and evaluate the proposed alternative mode of rating assessment, ensuring its suitability for broader implementation.

Further, proposed method can be recommended for implementation under the following conditions

- A. Implementation proposed mode based on further evaluation,
- B. The proposed mode suitable to apply in areas with poor rental markets

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