

# Core Element 6 – Appropriate Regulation

*“While this crisis had many causes, it is clear now that the government could have done more to prevent many of these problems from growing out of control and threatening the stability of our financial system. Gaps and weaknesses in the supervision and regulation of financial firms presented challenges to our government’s ability to monitor, prevent, or address risks as they built up in the system.”*

- U.S. Treasury Dept, *Financial Regulatory Reform*, p. 2, June 2009

The development of property markets depends on appropriate government regulation and the continuous development of regulators as markets become more sophisticated. Regulators tend to focus on the narrow confines of their jurisdiction. As market participants learn the system, they often begin to find ways to work around regulations, or shop around for a more lenient regulator or a less restrictive country to place their investments. These efforts to avoid regulation increase systemic risks and can lead to a cascading economic collapse.

Governments and citizens need to work together to make sure that the entire property market system is understood, fairly regulated and that there is continuous feedback between market participants and government agencies. This includes making sure that the entire tax regime is fair and does not place too much of the overall tax burden on property transactions or yearly property taxes. It also includes the certification, supervision and disciplining of property market professionals. Finally capital markets and capital market regulation must continually evolve and be transparent so that native capital can be put to the best use and additional capital can be attracted from abroad.

**Core Element Goal**

A comprehensive regulatory regime that is transparent, efficient, simple in its implementation and that leads to accurate reporting of property values and prudent protection from market risks

## Lead Indicator 6.1 – Fair Tax Regime

Core Question: Do market participants feel the overall tax rate is fair and participate in formal transactions?

Governments raise funds to provide services such as roads, police protection, sanitation and schools through taxation. Tax policies determine what goods, services and income will be taxed and how much each citizen will pay. Property tax has long been one of the primary forms of taxation as property owners often benefit the most from government services. Governments must be careful to ensure that tax rates do not become a disincentive for investment and that

tax rates continue to reflect market values. In today's global market governments also need to make sure that foreign investors are treated fairly.

### **Sub-Indicator 6.1.1 – Transfer Tax**

#### **What is the total property transfer tax including all duties and payments?**

- Step 1 Visit the *Doing Business* Web site: [www.doingbusiness.org](http://www.doingbusiness.org)
- Step 2 From the “select an economy” drop down select your country.
- Step 3 Click on “Registering Property”
- Step 4 Record the cost (% of property value)
- Step 5 Determine the Sub-Indicator Score:
  - Very Strong 3% or less
  - Strong 3.1 – 5%
  - Weak 5.1 – 10%
  - Very Weak More than 10%

### **Sub-Indicator 6.1.2 – Overall Tax**

#### **What is the overall tax rate on entrepreneurs?**

- Step 1 Visit the *Doing Business* Web site: [www.doingbusiness.org](http://www.doingbusiness.org)
- Step 2 From the “select an economy” drop down select your country.
- Step 3 Record your country's rank for “Paying Taxes” for the current and previous year.
- Step 4 Click on “Paying Taxes”
- Step 5 Review the information.
- Step 6 Determine the Sub-Indicator Score and trend:
  - Very Strong 1<sup>ST</sup> – 46<sup>TH</sup> countries
  - Strong 47<sup>TH</sup> – 92<sup>ND</sup> countries
  - Weak 93<sup>RD</sup> – 137<sup>TH</sup> countries
  - Very Weak 138<sup>TH</sup> – 183<sup>RD</sup> countriesTrend either ↑ or ↓ compared to previous year.

### **Sub-Indicator 6.1.3 – Divestment**

**Survey Question 26                      What is the tax on profits for foreign investors when divesting property?**

- Step 1                      Consult with local real estate managers, valuers or investment managers and analysts and ask about the tax rates on foreign investors.
- Step 2                      Conduct an Internet search using the terms “taxation [country],” “investment [country],” or “FDI – foreign direct investment [country]”
- Step 3                      From the interviews and research answer Survey Question 28.
- Step 4                      Determine the Sub-Indicator Score:
  - Very Strong              Domestic and foreign investors are treated equally and the tax rate is less than 15%.
  - Strong                      There are some restrictions on foreign investors and the tax rate is from 15 to 30%.
  - Weak                        Foreigners may only purchase real estate in limited circumstances, the government places significant restrictions on international payments, tax rates above 30%.
  - Very Weak                Foreigners cannot own real estate.

**Determine the Lead Indicator Score for Fair Tax Regime**

- Step 1                      Review the Sub-Indicator scores.
- Step 2                      Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

**Lead Indicator 6.2 – Professional Services**

Core Question:	Are the professional services necessary for efficient and transparent property markets available and appropriately regulated and supervised?
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Highly functioning property markets require that a competent and independent corps of service providers be in place to move markets, protect the public and advise the government in property development and taxation and the courts in disputes. This private sector support mechanism is primarily made up of valuers, brokers and agents and mortgage professionals. Brokers and agents act as market makers helping people realize that property is an asset base that they can sell, manage and upgrade. Mortgage professional help connect people to sources of long-term funding so they can unlock the value in their property.

Throughout the process, independent asset valuers help protect all parties by ensuring that properties are valued according to generally accepted valuation principles and the intended purpose of the valuation, i.e. for taxation, lending, government taking or financial reporting. Because of the importance of these professionals to the functioning of property markets throughout economic cycles, it is critical that governments regulate these professionals and establish disciplinary procedures to quickly remove fraudulent players.

### **Sub-Indicator 6.2.1 – Asset Valuers**

- Step 1 Consult with local real estate brokers and agents, managers or valuers and ask about the regulation of property valuers.
- Step 2 Conduct an Internet search using the terms “valuation profession [country]” or “property valuation [country]”
- Step 3 From the interviews and research answer the following:

**Survey Question 27      Are asset valuers licensed and/or certified by the government?**

**Survey Question 28      How effective are mechanisms in place to discipline valuers who engage in misconduct?**

#### **Civil Society Resource – Appraisal Foundation**

[www.appraisalfoundation.org](http://www.appraisalfoundation.org)

Founded in 1987, the Appraisal Foundation is authorized by the U.S. Congress as the source of appraisal standards and appraiser qualifications for real property appraisers. Through its effective production of the Uniform Standards of Professional Appraisal Practice (USPAP), the Foundation has been instrumental in setting a high level of professionalism in the industry.

The Foundation includes an International Valuation Council. The Council maintains contact and a reciprocal process to share experiences with other national standard and qualification setting bodies. The Council interacts with the International Valuation Standards Board, Regional Valuation Standards Boards and other National Valuation Standards and Qualifications Boards to facilitate strong and consistent national standards. The Appraisal Foundation is interested in identifying opportunities to encourage the implementation of valuation standards and qualifications in reconstructing economies and emerging and developing countries.

- Step 4 Determine the Sub-Indicator Score:
- Very Strong Licensing and certification of valuers by the government includes several levels and disciplinary procedures are in place and rigorously enforced.
  - Strong Licensing and certification of valuers by the government includes several levels and disciplinary procedures are in place and sporadically enforced.
  - Weak Only a small number of valuers are licensed by the government such as for the courts.
  - Very Weak Valuers are not licensed by the government.

### **Sub-Indicator 6.2.2 – Brokers & Agents**

- Step 1 Consult with local real estate brokers and agents, managers or valuers and ask about the regulation of brokers and agents.
- Step 2 Conduct an Internet search using the terms “real estate brokers [country]” or “real estate supervision [country]”
- Step 3 From the interviews and research answer the following:

**Survey Question 29 Are real estate brokers and agents licensed by the government?**

**Survey Question 30 How effective are mechanisms in place to discipline brokers or agents who engage in misconduct?**

- Step 4 Determine the Sub-Indicator Score:
- Very Strong All real estate brokers and agents are licensed by the government and disciplinary procedures are in place and rigorously enforced.
  - Strong Most real estate brokers and agents are licensed by the government and disciplinary procedures are in place and sporadically enforced.
  - Weak Only a small number of brokers and agents are licensed by the government with a large number of unregulated agents operating in the market.

Very Weak Brokers and agents are not licensed by the government and unregulated/unprofessional brokers dominate the market.

### **Sub-Indicator 6.2.3 – Mortgage Professionals**

Step 1 Consult with local real estate brokers and agents, managers or valuers and ask about the mortgage services available and mortgage professionals active in the market.

Step 2 Conduct an Internet search using the terms “mortgage [country]” or “mortgage financing [country]”

Step 3 From the interviews and research answer the following:

**Survey Question 31 Are mortgage professionals licensed and/or certified by the government?**

**Survey Question 32 How effective are mechanisms in place to discipline mortgage professionals who engage in misconduct?**

Step 4 Determine the Sub-Indicator Score:

Very Strong Mortgage loans are readily available, mortgage banks and mortgage professionals are regulated by the government, and disciplinary procedures are in place and rigorously enforced.

Strong Mortgage loans are available, mortgage banks and mortgage professionals are regulated by the government and disciplinary procedures are in place and sporadically enforced.

Weak Mortgage loans are only available to a small number of borrowers and the market is unregulated.

Very Weak Mortgage loans are unavailable.

### **Determine the Lead Indicator Score for Professional Services**

Step 1 Review the Sub-Indicator scores.

Step 2 Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

## Lead Indicator 6.3 – Capital Markets

Core Question:	Are capital markets well-regulated and diversified enough to provide financial resources to private-sector entrepreneurs and innovators?
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Well developed and regulated capital markets allow capital to flow to where it is most needed and the returns are greatest. Excessive state action to redirect the flow of capital is an imposition on both the freedom of the investor and the freedom of the people seeking capital. The more restrictions a country imposes on investment, the lower its level of entrepreneurial activity and economic growth. As the world becomes more interconnected, restrictions on the flow of capital into and out of a country increasingly place countries at a disadvantage not only in overall economic development but in basic levels of prosperity and individual freedom.

At the same time markets need transparent and prudent regulation to prevent elites and other insiders from taking advantage of their knowledge to drive prices beyond sustainable values based on core assets. The drive to profit must be balanced with auditing by independent analysts and regulators armed with accurate knowledge about company balance sheets and enough understanding of derivative instruments to accurately rate and control risks. With effective supervision and transparent knowledge of asset performance over time, securitization can occur and core assets can be leveraged to provide additional capital to entrepreneurs who in turn can raise the overall prosperity of the country.

### Sub-Indicator 6.3.1 – Capital Flows

#### How restricted is the flow of capital into and out of the country?

- |        |   |
|--------|---|
| Step 1 | Visit the <i>Global Competitiveness Report</i> Web site:<br><a href="http://gcr.weforum.org/gcr2010/">http://gcr.weforum.org/gcr2010/</a> |
| Step 2 | Click "Rankings."   |
| Step 3 | From the "Index" dropdown select Table 8.06 – "Restrictions on capital flows"   |
| Step 4 | Find your country on the table.   |
| Step 5 | Record the ranking and numeric score.   |
| Step 6 | Determine the Sub-Indicator score:  |
|        | Very Strong    1 <sup>ST</sup> – 34 <sup>TH</sup> countries   |
|        | Strong        35 <sup>TH</sup> – 69 <sup>TH</sup> countries   |
|        | Weak         70 <sup>TH</sup> – 104 <sup>TH</sup> countries   |
|        | Very Weak    105 <sup>TH</sup> – 139 <sup>TH</sup> countries  |

### Sub-Indicator 6.3.2 – Securities Exchanges

**Is the regulation of securities exchanges transparent, effective and free of influence from government and industry?**

- Step 1 From the GCR Index select Table 8.08 – “Regulation of securities exchanges”
- Step 2 Find your country on the table.
- Step 3 Record the ranking and numeric score.
- Step 4 Determine the Sub-Indicator score:
  - Very Strong 1<sup>ST</sup> – 34<sup>TH</sup> countries
  - Strong 35<sup>TH</sup> – 69<sup>TH</sup> countries
  - Weak 70<sup>TH</sup> – 104<sup>TH</sup> countries
  - Very Weak 105<sup>TH</sup> – 139<sup>TH</sup> countries

### Sub-Indicator 6.3.3 - Securitization

**What is the depth of asset-backed securities, mortgage-backed securities, high-yield bonds and highly leveraged loans?**

- Step 1 Download the latest *Financial Development Report*:  
[www3.weforum.org/docs/WEF\\_FinancialDevelopmentReport\\_2010.pdf](http://www3.weforum.org/docs/WEF_FinancialDevelopmentReport_2010.pdf)
- Step 2 Scroll down to Part 2: Country/Economy Profiles.
- Step 3 Find your country and review the profile (for countries not covered go to Step 6).
- Step 4 Record the ranking and numeric score for “Securitization” under the 5<sup>th</sup> Pillar: Non-banking financial services.
- Step 5 Determine the Sub-Indicator score:
  - Very Strong 1<sup>ST</sup> – 13<sup>TH</sup> countries
  - Strong 14<sup>TH</sup> – 28<sup>TH</sup> countries
  - Weak 29<sup>TH</sup> – 43<sup>RD</sup> countries
  - Very Weak 44<sup>TH</sup> – 57<sup>TH</sup> countries
- Step 6 Conduct an internet search using the term “securitization [country]”
- Step 7 Conduct interviews with local bankers, investment managers and/or government officials and ask them about securitization contracts or plans for securitization in the country.

- Step 8 Determine the Sub-Indicator score:
- |             |  |
|-------------|--|
| Very Strong | Not applicable   |
| Strong      | Not applicable   |
| Weak        | Securitization laws are in place and some contracts have been issued within the country. |
| Very Weak   | No securitization is taking place within the country.                                    |

### Determine the Lead Indicator Score for Capital Markets

- Step 1 Review the Sub-Indicator scores.
- Step 2 Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

### Determine the Core Element Score for Appropriate Regulation

- Step 1 Review the Lead Indicator scores.
- Step 2 Determine the Core Element Score based on the aggregate of the Lead Indicator scores.

### Core Element Linkages

Appropriate Regulation ↔ Effective Governance

Continued macroeconomic development is dependent on continual microeconomic improvements. While democratic processes, the lack of corruption and an effective civil service are essential to basic economic stability, sustained economic growth requires that governance reforms be matched by effective and efficient regulation. A feedback loop between those charged with implementing policy and policy makers is essential.

For property markets this means that tax systems must be diversified and rates low enough to keep from driving transactions underground. Professional service providers must not only be well-trained and supervised, but they must have influence on policy makers so that identified risks can be mitigated by government action. Finally the right balance must be struck between the demands of the market and the overall public good.

Please refer to the information for Effective Governance on page 33.

## Field Assessment

Property markets come full circle when supporting institutions allow properties to not only be registered, used as collateral and sold for the first time, but when properties are sold for the second, third and fourth times. These sales start to unlock value creating more liquid assets that grow in value over time. Property markets are created by market makers who help define and drive the emergence of market bids, offers, valuation and exchange.

- Step 1 Partner with an outside expert with property market experience – preferably someone with transactional experience in a formal market outside your region.
- Step 2 Together with the expert, visit local property brokers, agents and valuers and ask them to tell you about recent experiences in listing properties for sale, sales contracts, closings and compensation. Be sure to include information about both residential and commercial properties.
- Step 3 Determine the answers to the following questions:

## Taxation

**Field Question 21** What is the overall taxation system in regards to property?

## Brokerage

**Field Question 22** What is the number of practitioners in the country including full-time brokers/agents with formal training and part-time, informal brokers?

**Field Question 23** What is the number and average size of brokerage companies?

**Field Question 24** Are there brokers associations active in the market? What number and what percentage of practitioners belong?

**Field Question 25** What training programs are available to enhance productivity?

**Field Question 26** Is there a Code of Ethics or standards that practitioners follow? Is the Code enforced?

**Field Question 27** Do civil society organizations exist to support the development of mortgage professionals?

# Core Element Map for Appropriate Regulation

**Legend** – colors indicate the strength of institutions that support property markets.

- Very Strong
- Strong
- Weak
- Very Weak
- Unknown



## Core Element Map Color Guide



### Color Indicators

To maintain consistency, all Core Element maps should use the same color indicators. The Crystal Mapping editing feature is reproduced above.

- Step 1: Follow the Crystal Mapping software instructions to create a map for your country with 6 first level (Core Element) segments, 3 sub-segments (Lead Indicator) for each first level and 3 sub-segments (Sub-Indicators) for each second level segment.
- Step 2: Roll over a segment and click on the “E” to edit the segment.
- Step 3: Click “Details.”
- Step 4: Click on the “Change Segment Colour” box.
- Step 5: Choose the appropriate color from the chart according to the following key. The first number is for the row, the second for the column.

Property Rights	Very Strong – 4:15 (For very strong indicators, change the text color to white.)
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	Strong – 10:3 Weak – 12:11 Very Weak – 6:1 (for all maps) Unknown – 3:1 (for all maps)
Access to Credit	Very Strong – 1:5 Strong – 7:8 Weak – 4:20
Effective Governance	Very Strong – 7:18 Strong – 8:19 Weak – 9:20
Rational Dispute Resolution	Very Strong – 4:3 Strong – 6:5 Weak – 6:19
Financial Transparency	Very Strong – 1:7 Strong – 2:20 Weak – 10:8
Appropriate Regulation	Very Strong – 7:10 Strong – 8:18 Weak – 9:18