11. Property Taxation in Kenya[1]

Role of Property Taxes within Local Authorities in Kenya

Property taxes (known as Rates) provide an average of 20 percent of the total recurrent revenues for local authorities and represent 1 percent of total government tax revenue and 0.25 percent of GDP. Property Rates in 2000/2001 provided Ksh 1.5 billion (US$19.2 million)—broken down as follows: Ksh 1.4 billion and Ksh 83 million to the Municipal Councils and to Town, Urban and County Councils, respectively.[2]

As Table 1 indicates, property rates account for 34 percent of total own source tax revenues for municipalities and only 4 percent of own source revenues in towns and counties. As expected, the property tax is a more important revenue source for municipalities due to the existence of valuation rolls that capture the larger, more valuable tax base.

Table 1: Property Rates Revenues as % of Own Source Revenues and Own Source Tax Revenues, FY 2000-2001 (Ksh)

	Municipalities	Towns and Counties	Total
Property Rates	1,446,272,586	83,058,613	1,529,331,200
Total Own Source Revenues	5,805,505,797	1,923,890,235	7,729,396,032
Total Own Tax Revenues	4,205,487,849	1,913,765,919	6,119,252,768
Property Rates as % of Own Source Revenues	25	4	20
Rates as % of own Tax Revenues**	34	4	24

** Excludes revenues from water supply. Source: Ministry of Local Government, 2001

In inflation-adjusted real terms, Rates revenues have been declining since 1991. As a percent of local authority revenues, Rates have declined in importance from 26% in 1990/91 to 22% in 1994/95 and to 20% in 2000/01, while revenue from Rates has fallen from 0.37 percent of GDP in 1990/91 to 0.30 percent of GDP in 1995/95 to 0.25% of GDP in 2000/2001. Thus, the importance of Rates in Kenya is (1) declining in real terms over time, (2) declining in relative contribution to total local authority recurrent revenues and (3) declining as a percent of GDP.

[1] Prepared by Roy Kelly, Duke University.

[2] These figures come from FY 2000-2001 collections as recorded through the Local Authorities Transfer Fund (LATF) financial submissions (Ministry of Local Government). These figures are consistent with those issued annually by the Central Bureau of Statistics Annual Economic Survey—for which the latest figures, issued in 2001, are for FY 1998/99.

Property Tax Base

In Kenya, the Rating Act allows local authorities to tax either land or land and improvements (e.g., buildings). Although the first application of "Rating" in Mombasa in 1921 was based on land and improvements (i.e., the annual rental value of occupied premises), all property Rates in Kenya are currently levied only on land.[3] Improvements (e.g., buildings and structures) are not taxed. In addition, most local authorities exclude "freehold" land, agricultural land less than 12 acres, and indeed most private land in the area rating rolls.[4] Public land (both central government land and council trust land) which is not yet "registered" is also excluded from the private valuation roll—although technically this land should be listed on the public valuation roll and be liable for Contributions in Lieu of Rates.[5] In addition, allocated council trust land not yet registered is not liable for either rates or Contributions in Lieu of Rates.

Although variation in rating is allowed under the law, in practice, all local authorities limit their assessment to area rating and valuation rating. Out of the 174 local authorities in Kenya, there are 102 that use some form of property taxation. Of these 102 rating authorities, 75 use valuation rating, 55 use area rating, while 29 use a combination of both area and valuation rating. As Table 2 indicates, municipalities and towns tend to rely on valuation rating while counties tend to use area rating or a combination of area and valuation rating. Area rating tends to be used for rural or agricultural properties while valuation rating tends to be used for more urbanized properties.

Table 2: Breakdown of Property Rating in Kenya (2001)

Type of Local Authority Councils	Number of Rating Authorities	Number using Valuation Rating	Number using Area Rating	Number using both Area and Valuation Rating
Municipalities	36	36	8	9
Towns	27	24	12	9
Counties	39	15	35	11
Total	102	75	55	29

Source: Ministry of Local Authorities, 2001.

[3] The Government of Kenya, *The Rating Act (cap 267),* 1972 and *the Valuation for Rating Act (cap 268),* 1972 provides for three types of rates: area rate based on the size and use of the land; unimproved site value rate is based upon the capital value of the bare land and the site value; and improvement rate is based on the land and improvements separately. *The Rating Act, 1972,* provides extreme flexibility in defining the tax base. Rating authorities may use an area rating, an agricultural rental value rate, a site value rate or a site value rate in combination with an improvement rate. For area rating, *The Rating Act* (Section 5) again provides flexibility to use one of five different options, including the use of a flat rate or a graduated rate upon the area of land, differentiated flat or graduated rates according to land use or any other method of rating upon land or buildings that the rating authority may resolve.

[4] Most local authorities do not tax freehold land. This is especially true for agricultural freehold land. The arguments given are (a) that these properties are already taxed through the agricultural cess, (2) that these properties do not receive local authority services and (3) that these properties are not legally obligated to pay property taxes. Much of the peri-urban land is not included in the tax base because the *Agricultural Act* which exempts farms less than 12 acres. The only exception is when an agricultural plot is subdivided into residential use, at which time, the local authority will include the property on the valuation roll.

[5] The Rating Act (Section 23) stipulates that the Government must pay an annual "contributions in lieu of rates" (CILOR) to the local authority. This CILOR is, in essence, the property rates owed by the government for its property. Although the Government owes Ksh 396 million (US$5 million) on an annual basis it has historically allocated only a portion of the liability. In FY 2000-2001, the Government paid Ksh 110 million (less than a third of what was owed). CILOR arrears are estimated to be Ksh 2.55 billion.

In Kenya, the fiscal cadastre information can be broken into two components. **First**, there is a valuation roll that contains land information and values for properties taxed under an ad valorem rate. This valuation roll is broken into the private valuation roll and the public valuation roll and typically covers only land located in the established, gazetted area of local councils. **Second**, there is property tax information that is used for area rating purposes for land outside the gazetted area of town and municipal/town councils. This information covers the peri-urban areas that are taxed under a system of area rating. Although this area rating roll can contain both private and public land, it is used primarily for government forests and large farms. Rural agricultural land (if included in the tax roll) is typically taxed on an area basis while urban land (or built up areas) is typically taxed on an ad valorem basis.

Property tax assessment is the responsibility of the local authority, which must identify a valuer to prepare the valuation rolls. The valuer can either be a council employee, from the Ministry of Lands or from the private sector. The valuer, as an individual, is responsible for gathering the necessary land information, ascertaining a value, and producing the valuation roll for the local council. The council then tables the valuation roll, informs the public, and handles the objections. The valuation is then certified by the council and used for taxation purposes.

Local authorities do not have the capacity to systematically maintain and coordinate their fiscal cadastre information.[6] With the exception of Nairobi, Mombasa, Nakuru and Kisumu, local authorities depend on the Rating Department under the Ministry of Lands to create and update their valuation rolls. All fiscal cadastre information is maintained on a manual basis: computers are not used at all for fiscal cadastre maintenance. Valuation rolls were to be prepared every five years but this was changed to every 10 years in 1991. However, the law does provide for the production of supplementary tax rolls on an annual basis as required. As Table 3 confirms, however, these various rolls are not kept up-to-date. Many of the current valuation rolls date back to the early 1980s, with sporadic and ad hoc issuance of incomplete supplementary valuation rolls. Nairobi Municipal Council, for example, uses a valuation roll from 1982, accompanied by sporadically issued annual supplemental rolls.[7] There are at least 18 local authorities using valuation rolls over ten years old.

Table 3: Current Status of the Selected Valuation Rolls in Kenya

Year of Valuation Rolls	Number of Local Authorities
1982-1985	18
1986-1990	31
1991-1995	19

Source: Ministry of Lands, 1996

[6] At one time, Kenya was considered a "model" with respect to its land titling and cadastre (P.F. Dale, *Cadastral Surveys within the Commonwealth* (London: HMSO, 1976), p. 234). More recent studies, however, agree with the position taken in this paper: see, for example, W. Olima, "Real property taxation in Kenya," in W. McCluskey, ed., *Property Tax: An International Comparative Review* (Aldershot, UK: Ashgate, 1999), pp. 358-74, and R.A. Aherne, "Nations of Eastern Africa," in R.V. Andelson, ed., *Land-Value Taxation Around the World* (3rd ed.; Malden, MA: Blackwell, 2000), pp. 277-80. [Note added by editors]

[7] Nairobi City Council just issued a revised valuation roll in November 2001. Appeals are now being made and heard before the roll can be used for rating purposes.

Property Tax Rates:

In Kenya, the Rating Act gives the local authority the power to set the tax rate. The tax rate can be set either as a per unit rate in the case of area rating or as a per value rate in the case of valuation rating. The unit area or the value rate can be either uniform or differential. The differential rates can either be proportional or graduated based on land use, value, or size. Local authorities are allowed to choose a valuation rate of up to four per cent without central government approval. The Minister of Local Government must approve all tax rates higher than 4 percent as a precautionary measure to protect the interests of the taxpayers.

In general, local authorities in Kenya tend to use a uniform area rate or a uniform tax rate structure. As Table 4 indicates, the tax rates range from 2 to 22 percent applied to the values contained on the valuation rolls. The median tax rates are 6 percent for both municipalities and towns and 5 percent for counties. Those jurisdictions with the higher tax rates tend to be those with the oldest valuation rolls. Only a few local governments apply a classified tax rate structure. The most notable is Mombasa, which differentiates tax rates by location: properties located on Mombasa Island are taxed at a higher rate than properties located on the mainland. Nairobi City Council also uses differential rates based on land use (eg, residential, commercial and industrial).

Table 4. Range of Tax Rates by Type of Local Authority, 2000

Type of Local Authority	Range of Tax Rates (%)	Median Tax Rates
Nairobi City Council	14%	14%
Municipality	2% to 10%	6%
Towns	2% to 8%	6%
Counties	2% to 22%	5%

Source: Ministry of Local Government, 2001.

The tax rates used are highly correlated with the age of the valuation roll being used. Typically, as discussed above, the valuation rolls are dated. Therefore, to compensate for the lag in revaluations, the Government has allowed local councils to increase nominal tax rates. In Nairobi, for example, the tax rate for residential property increased from 2.25 percent in 1982 to 5 percent in 1991 and to 14 percent in 2000. This increase has almost equaled the rate of inflation thereby holding the average real tax burden per residential property almost constant over the past 20 years.

Tax Administration

Property tax administration is the responsibility of the local authorities (LAs). They are responsible for the construction and maintenance of the tax roll, the valuation, the assessment, tax billing, collection, enforcement, appeals and taxpayer service. The local authority can use in-house staff, other government departments (e.g., Ministry of Lands) or the private sector to assist in any or all of theses functions. As mentioned earlier, most LAs rely on the Ministry of Lands for the production of the valuation rolls, with only a few LAs using private sector valuers. All other administrative functions tend to be carried out by the council. The exception is for revenue collections in some of the major municipal councils which have given contracts to private sector lawyers—typically with disappointing results.

Tax administration is the weak link of property taxation in Kenya. In general, the revenue base information is incomplete, collections are low, and enforcement is virtually non-existent. The basic policy guidelines provide a flexible framework for an effective property tax system. The primary obstacle to successful local revenue mobilization is weak administration. Weak administration, combined with a lack of political will for enforcement, generates a low level of local revenue mobilization performance.

The weakest component in tax administration is collection and enforcement. Collection rates range from 5-60 percent of liabilities. This is attributable to such factors as (1) lack of taxpayer confidence or understanding in how the tax is levied, collected, and enforced, and used, (2) lack of legal and administrative collection and enforcement mechanisms, and—perhaps most importantly—(3) lack of political will.

Despite having a variety of options under the Rating Act, the rating authorities have taken a largely passive role in enforcement, relying almost exclusively on rate clearance certificates. This clearance certificate option relies on taxpayer initiative to clear outstanding debt and is thus only effective when the property is being transferred or when a local business license or permit is being requested from the local authority.

Active enforcement (through fines, tax liens and foreclosures) by the government is virtually non-existent. Several local authorities, such as Nairobi and Mombasa, occasionally publish the names of delinquent taxpayers in the newspaper. Other local authorities initiate court cases against delinquent taxpayers, with mixed results. To date, no local authority has applied the legal option of tax caveats to titles or used property foreclosures as a means to enforce tax payment. To improve tax compliance, political will must be mobilized, administrative systems must be rationalized and improved, and local officials must be made aware of the legal and procedural provisions for enforcement.

In general, the fiscal cadastre information and the valuation rolls in Kenya are neither up-to-date nor complete. It is estimated that the fiscal cadastre and valuation rolls may only include between 20-70 percent of the total taxable land. These registries tend to be incomplete and out of date due not to the lack of trained valuers in Kenya but rather to the lack of proper incentives and the reliance on individual "single parcel" valuation. Kenyan valuers tend to allocate their time to non-rating valuation activities owing to the relative lack of renumeration for doing valuation rolls. Kenya also does not use any form of mass valuation, thus making the valuation process both costly in terms of time and resources. All property records (with the exception of only a few LAs) are kept manually and maintained in an ad hoc and periodic manner. The legal basis to ensure an up-to-date and complete valuation roll is adequate—the problem is with administration.

The key to increasing local revenue buoyancy of business licenses and property taxation in Kenya is through improved administration and strong political will. The LAs must ensure that revenue is collected and enforcement undertaken against noncompliance, that all properties and businesses are captured in the respective registries, that property is valued based on accurate relative values, and that the tax levy is assessed accurately. The collection ratio (i.e., the extent to which the liabilities are collected and enforced), coverage ratio (i.e., the extent to which the tax objects are captured on the tax rolls), and the valuation ratio (i.e., the extent to which the tax objects are valued accurately or classified correctly) are the critical administrative variables that ultimately determine effective tax rates, the tax burden for each property, the total revenue yield, economic efficiency and overall fairness. Kenya must therefore strengthen the LAs capacity to manage and administer all aspects of the property rates in order to increase the collection, coverage and valuation ratios, as necessary.[8]

The Context and Rationale for Property Tax Reform

The Government of Kenya is currently implementing a series of local government reform initiatives through its Kenya Local Government Reform Programme (KLGRP). The ultimate KLGRP objective is to strengthen the ability of local authorities to improve service delivery, enhance economic governance and alleviate poverty. It is expected that better functioning local authorities will lead to an enabling environment for improved economic and social development ultimately leading to increases in incomes and to the alleviation of poverty.

The KLGRP was initially conceptualized in the early 1990s and became operational in 1998. From its beginning, the local government reform focused on (a) rationalizing the central-local fiscal relationship, (b) enhancing local financial management and revenue mobilization and (c) improving local service delivery through greater citizen participation.

The KLGRP reform strategy recognized that successful local government reform must focus both on the **internal** operating environment within the local authorities themselves and the **external** intergovernmental environment—that strong local governments can only function well internally within a strong enabling external intergovernmental fiscal environment. The key then was to strategically implement the KLGRP reform initiatives, focusing first on establishing a rational external environment and then linking those intergovernmental reforms to provide incentives to strengthen the internal functioning of local authorities.

First priority was therefore placed on developing a rational central-local government fiscal relationship. This led to the design, enactment and implementation of the Local Authorities Transfer Fund (LATF) that was enacted into law in 1998. This LATF is the first intergovernmental grant system in thirty years and now serves as the flagship of the KLGRP reform effort, providing a mechanism to link a variety of important reform initiatives to the grant system such as improved local service delivery, financial management, debt resolution, and revenue mobilization.

Improved local financial management and revenue mobilization are also critical components of the KLGRP reform initiative. In 1999, the Government introduced the Single Business

[8] For further discussion of the various administrative ratios, see Roy Kelly, "Designing a Property Tax Reform Strategy for Sub-Saharan Africa: An Analytical Framework applied to Kenya" Public Budgeting & Finance, Vol. 20 (2000), pp. 36-51.

Permit (SBP) system that replaced the previous system of multiple local licensing.[9] Linked to the establishment of the SBP, the Government developed a prototype Integrated Financial Management System (IFMS) to assist improve the management, operation and control of all local financial operations. This IFMS includes a property tax administrative management system to assist in all operations related to tax base maintenance, valuation, assessment, billing, collection, enforcement and taxpayer service.

The KLGRP property tax reform strategy was designed to be implemented within the context of this broader KLGRP reform initiative. Linking the property tax reform as an integral component of the broader local government reform effort provides the proper context for the reform itself and builds on the existing political support and reform momentum—for example, the establishment of the Local Authorities Transfer Fund, the Single Business Permit and the Integrated Financial Management System. The KLGRP reform—and its property tax reform component—will need strong and sustained political, policy, operational, public and technical assistance support to be successful.

One of the key KLGRP objectives is to establish a sustainable local revenue mobilization capacity to generate the needed own-source resources—to be combined with the central-local transfers—for improving local service delivery, enhancing economic governance and alleviating poverty.

Description of reform:

An evaluation of the legal basis for the property rates showed that there are virtually no legal constraints to improved property rates collections. The primary problem is weak administration and the lack of political will. The law itself provides flexibility in tax base definitions, tax rate structures, valuation techniques, assessment, billing, collection and enforcement.

The property tax reform strategy under the Kenya Local Government Reform Programme (KLGRP) was therefore designed to focus on administrative reform—primarily improving the collection and enforcement systems—and the mobilization of political will. Only after progress is made on collection and enforcement should attention be focused on ensuring complete coverage and improved valuation.

An evaluation of revenue collections from property rates shows an extremely low collection rate with virtually no enforcement against non-compliance. Thus, rather than focusing on legal provisions, the rates reform has focused on improving the basic administration components. This has been accomplished through including the property tax management system within the Integrated Financial Management System (IFMS). The focus has been on improving the basic administration management of the property rates system—linking the basic revenue administrative component (e.g., database maintenance, assessment, billing, collection, enforcement and taxpayer service) with other revenue sources such as the single

[9] For further information on the SBP reform effort, see Nick Devas and Roy Kelly, "An Analysis Of Local Business Licences, With A Case Study of the Single Business Permit In Kenya" Public Administration and Development, (2001)

business permits, house rents, plot rents, and user charges. Linking the various systems systematically provides for consistency and simplicity in introducing financial management reforms to the LAs.

The IFMS system—which includes the property rates components—was first introduced and field tested in 1999 in two local authorities. Subsequently the IFMS system has been further tested in two additional LAs—including one rural county council. By June 2002, the IFMS system will be fully operational in these four LAs. In FY 2002-2003, the IFMS system (and relate reforms) is expected to be replicated to additional LAs in accordance with the Ministry of Local Government's replication strategy.

In addition to incorporating the property rates administrative improvements into the IFMS, the KLGRP conducted two pilot projects to test a simple and cost-effective field methodology for collecting property information required to extend the tax base, ensure a more complete coverage and developing a computer-assisted mass valuation model. The field data collection techniques for constructing and maintaining the property rates fiscal cadastre information was conducted in Mavoko Municipal Council. This pilot enabled the refinement of the field data collection procedures and confirmed that the current rates rolls were missing many properties (i.e., the property coverage ratio was low). Improving the coverage of the valuation rolls to ensure that all properties are captured and assessed will broaden the rates base, improve equity and generate additional revenues.

The mass valuation pilot project was carried out in two LAs—Mavoko Municipal Council and Nyeri Municipal Council. The results showed that it would be possible to shift from the current single parcel appraisal approach to a simpler, more cost effective mass appraisal approach. However, the work on property tax revealed that the major obstacle to improved property rates is not valuation but poor administration and the lack of political will for collection and enforcement. Therefore, the project focused its attention on improving the property rates administrative procedures through developing a rates module within the Integrated Financial Management System (IFMS). Once the IFMS is fully operational—after ensuring effective billing, collection and enforcement—the Government will be able to begin replicating these fiscal cadastre and mass valuation components to other LAs.

Preconditions for reform:

The Kenya Local Government Reform Programme—and its property rates reform component—is at a very early stage of implementation. The focus has been on strengthening the revenue collection and enforcement components. The primary obstacle to enhancing revenues is weak administration and the lack of political will.

Mobilizing political will requires education and incentives to those involved in the revenue mobilization effort. The taxpayer must be convinced to pay the tax through receiving improved local services and perceiving that the taxes and fees are being administered fairly. The first priority must therefore be to improve service delivery—since people are always more willing to pay taxes and fees if in return they receive some tangible benefits or services. Improved service delivery is therefore one of the KLGRP priorities.

As with all taxes, attention should also be given to educating the taxpayer on the rationale, procedures, obligations and responsibilities related to the business licenses and property tax. Linking revenue collections to improved service delivery and a better-educated taxpayer population will enhance compliance. Mobilizing the community through enhanced participatory budgeting and civic participation will engage the citizens and also facilitate enhanced revenue collection. Enhanced citizen participation and economic governance is one of the KLGRP priorities.

The government must strictly follow the established laws, regulations and procedures to earn the credibility that the taxes and fees are administered in a transparent, accountable and fair manner. Management and operational staff must be motivated to assist in the revenue mobilization effort—to ensure that the property tax/business registers are complete and kept up to date, assessments are calculated properly, tax demand notices are distributed, taxpayers are made aware of their obligations and the procedures to pay, and taxes and fees are collected systematically and fairly from all rate payers and businesses. Close supervision and improved management of revenue collectors can improve the revenue yield and equity of the rating and business licensing system. Enforcement against noncompliance is essential.

Local authorities need to improve service delivery to show effective use of taxpayers' money, while at the same time taxpayers need to be educated on the rationale, procedures and responsibilities related to the property tax. In addition, the property tax needs to be administered fairly and effectively to gain the confidence of the taxpayers in the equity of the tax. This requires the development and implementation of an improved revenue administrative system that will include property identification and management, valuation and assessment, billing and collection, enforcement and taxpayer service. As part of taxpayer/customer service, it is essential to improve public relations to ensure acceptance by future taxpayers.

In short, the major constraint to improved property rates is not technical (i.e., the ability to administer the property tax) but rather political (i.e., the willingness to administer the property tax). Current discussions about expanding the tax base to include improvements are irrelevant since the problem is not the size or the value of the tax base but rather the inability to collect and enforce the tax that is currently due. The focus must be on mobilizing the necessary political will to administer the tax in a comprehensive and equitable manner. Until this lack of political will can be overcome, it is hard to justify investing significant resources into further improving the administration by expanding the tax base and improving values.

Impact of reform:

As stated previously, the Kenya Local Government Reform Programme components—including the property rates reform—are at their very early stages of implementation. The new policies and procedures have only been operational for three years. Thus, although laws and regulations have been enacted and there has been some initial success in reform implementation, the reforms are still quite fragile, needing time to mature and to be further institutionalized within the central and local governments prior to massive replication and acceleration.

Given the fragility of the KLGRP reforms to date, the Government must carefully and systematically monitor the implementation experience, refining the policies and procedures, providing training and technical assistance, and managing the reform process. This requires time and a major infusion of personnel and financial resources, capacity development and improved reform management. Ultimately it is essential that the LAs can both initially implement and sustain the various reforms and that the central government can effectively manage, support and monitor the reform process. This is especially true as reforms such as the integrated financial management system (IFMS)—and the property rates reform components—are replicated to other LAs.

It should be stressed that each KLGRP reform component is focused on transforming the existing local government system—its policies, procedures and administrative structure—into a more accountable, transparent and efficient service delivery institution, one that can promote increased economic and social development to assist poverty alleviation. This institutional and cultural transformation is a dynamic process that takes time for all stakeholders to absorb, internalize and institutionalize the new policies and procedures

To date, the Kenya Local Government Reform Programme components are beginning to make progress. The Local Authorities Transfer Fund (LATF) is now distributing 5% of the national income tax to 174 LAs. LAs are now beginning systematically to prepare and submit annual financial statements, revenue enhancement plans, and participatory service delivery plans. The IFMS system is now being implemented. Local budgets will begin becoming more realistic—hopefully with a harder budget constraint. Revenue enhancement plans will begin becoming more realistic and useful as a means of encouraging increased and more accountable local revenue mobilization.

Once the momentum of these reforms begin yielding more substantial results, it will be possible to further mobilize the necessary political will to begin introducing the necessary administrative changes for enhancing property tax revenues in Kenya. Prior to this, however, any resource investment in improving the quality of the fiscal cadastre information and the valuations would not yield the needed property taxes for improved local services.