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Real estate valuation analysis in Kosovo

Visar Hoxha in Alenka Temeljotov Salaj

ABSTRACT

The purpose of this research paper is to provide an overview of the structure of real estate valuation practices in Kosovo with the special emphasis on property valuation using GIS system. Furthermore, in this paper we will examine the real estate valuation and its methods, the implementation of standard methods of valuation, the source of data for real estate valuation such as Immovable Property Rights Register in Kosovo (Section 1 of Law no. 2002/5 dated 17.10.2002 on the establishment of the immovable property rights registries), Kosovo Cadastral Land Information Systems, and WebGIS, and the purpose of real estate valuation in Kosovo such as expropriation, mortgage, taxation, and property transactions. The methodology used in this research is based upon the critical review of the existing literature on the matter, whereas empirical information was obtained through structured interviews with practitioners in Kosovo. The real estate valuation in Kosovo can also be conducted through GIS system, which entails both time and technology. Because of data and technology constraints we are obliged to focus this study only on the capital of Kosovo, Prishtina and apartments in Prishtina as a particular type of property. There are two ways of real estate valuation by means of GIS. First, we can create a model in which we input all independent variables that affect the value of real estate such as location, proximity to the road, proximity to urban traffic and so forth only for Prishtina. Second we can develop a model through Multi Regression Analysis and using a software such as ArcGIS and MapInfo. The main source of GIS data is the Kosovo Cadastral Agency through its GIS Directorate, in particular air photographing. Research results show that the most commonly used valua-

tion method in Kosovo is sales comparison approach. It is seen that GIS software and GIS collected data can be very useful in identifying appropriate comparables in Kosovo. We find that the law that regulates the real estate needs to be amended in order to make it mandatory for the real estate owners to register the actual real estate price, which would provide real comparative statistics to the real estate appraiser.

Keywords: real estate valuation, Kosovo, GIS system.

Analiza ocenjevanja nepremičnin na Kosovu

IZVLEČEK

Namen raziskovalne naloge je podati pregled prakse s področja ocenjevanja vrednosti nepremičnin na Kosovu s posebnim poudarkom na vrednotenju nepremičnin z uporabo GIS sistema. Poleg tega so v prispevku proučevane realne cenitve nepremičnin, uporabljene metode in implementacija standardnih metod vrednotenja. Uporabljeni viri podatkov za vrednotenje nepremičnin so Zemljiška knjiga (člen 1 zakona št. 2002/5 z dne 17. 10. 2002, Kosovo, o vzpostavitvi nepremičnega registra pravic lastnine), Katastrski Informacijski sistem 'WebGIS'. Nepremičninske cenitve so opravljene v skladu z namenom vrednotenja nepremičnin na Kosovu, kot so razlastitev, hipoteke, obdavčitev ter transakcije. Uporabljena je bila raziskovalna metoda kritičnega pregleda obstoječe literature z danega področja ter empirična raziskava, s pomočjo izvedbe strukturiranega intervjuja s praktiki iz Kosova. Vrednotenje nepremičnin na Kosovu je izvedeno tudi s pomočjo GIS sistema, vključujoč čas in tehnologijo. Zaradi nedostopnosti širših podatkov in tehnoloških omejitev, se raziskava osredotoča na študijo v Prištini, ter apartmaje v Prištini kot posebno vrsto premoženja. S pomočjo GIS sta opravljena dva načina vrednotenja. Najprej je pripravljen model, katerega vhodni podatki so vse neodvisne spremenljivke, ki vplivajo na vrednost nepremičnin, kot npr. lokacija, bližina ceste, bližina mestnega prometa in tako naprej, samo za Prištine. Nato je razvit model z Multi regresijsko analizo z uporabo programske opreme, kot so ArcGIS in Map-Info. Glavni vir podatkov GIS je Katastrska agencija iz Kosova

prek Direktorata GIS, predvsem iz fotografiranja iz zraka. Rezultati raziskave kažejo, da je metoda neposredne primerjave prodaj najbolj razširjena ocenjevalna metoda na Kosovu. Videti je, da je GIS informacijski sistem na Kosovu uporaben z vidika zbranih primerjalnih podatkov. Za namen boljše in kontinuirane statistike primerjalnih cen, je potrebno izboljšati zakonodajo v delu, ki ureja ocenjevanje nepremičnin, na način, da bi nepremičninski lastniki morali obvezno vpisovati aktualne prodajne cene nepremičnin v nepremičninski register.

Ključne besede: ocenjevanje vrednosti nepremičnin, Kosovo, sistem GIS

Introduction

The common recognition is that real estate markets are important for ensuring the competitive position of mature economies, and as such the use of real estate as an investment asset and as collateral for secured lending is likely to increase in importance in transition economies as they approach the market based system, including Kosovo. The more real estate market of Kosovo becomes prey to international investors, including Kosovar Diaspora there is a greater logical link between the maturity and sophistication of the real estate market with the quality of real estate valuation. In Kosovo as part of a former communist country, the economy was managed centrally and there were no free market forces that would determine the values of real estate. With no identifiable marketplace, in all former communist countries of Central and Eastern Europe, there was no challenge to the pre-determined valuation methodologies introduced by their various governments or to question the limitations of prices and values.¹ Previous communist economics used only one method of valuation, which was based on the cost approach.²

Use of Real Estate Valuation in Kosovo

A valuation (appraisal) is an estimate and opinion of value. It is not a statement of value or a fixing of value. It is only one per-

¹ H. Gelbtuch, D. Mackmin, and M. Milgrim, *Real Estate Valuation in Global Markets*, Illinois, 1997.

² N. Triphonov, *The Practice of Appraisal in Transition Economies*, AJ, 2002, p. 134.

son's opinion, based on whatever skills, training, data, dedication and/or objectivity that person possesses. For the same property different valuers may have different valuations. The economic interpretation of value is that the value of real estate is limited. Most economic resources are limited; if they can be used then the need for them is created. In today's market economy such value is expressed in terms of prices established through the marketing process. In terms of marketing the placement of useful value to things (use) is established through the level of desire for that resource.³ In this regard Bojan Grum argues that the price of real estate is established by the price of last unit sold. The exchange value of real estate is the value that grows from the total market demand for real estate. The subjective use value (investment value) must equal the objective exchange value (market value), which is indicated in the form of market price.⁴

Scholars argue that the occasions when the real estate valuation is performed are market transactions (purchase, sale, and exchange; financing; leasing; management; insurance coverage or claim; remodeling and development; feasibility and highest and best use studies; exercise of purchase or lease options) and legal transactions (property tax assessment and tax appeals cases; estate, inheritance, and gift taxes; income taxes-causal loss; depreciation basis, and capital gains reporting; personal and corporate legal actions; environment impact report; loan foreclosures; company liquidation, merger, and bankruptcy).⁵ In this regard, the valuation is defined as an analytical process, based on the knowledge of economic principles and assessment of economic benefits that the real estate would produce within the uncertain time interval.⁶ According to structured interviews from the practitioners in this field in Kosovo, the real estate valuation is usually performed for the following reasons: tax purposes, Commercial purposes, Mortgages or loan purposes, and Compensation from expropriation.

³ B. Grum and A. Temeljotov Salaj, *Interdisciplinarni vidiki nepremičnin*, 2011.

⁴ *Id.*, p. 23.

⁵ R. Betts and S. Elly, *Basic Real Estate Appraisal*, Ohio, 6th edn., 2005.

⁶ B. Grum and A. Temeljotov Salaj (footnote nr. 3), p. 24.

Normative background and real estate appraisal system

As stated above in Kosovo, the real estate valuation is performed for three following purposes: a) tax purposes; b) commercial purposes; and c) expropriation.

First, the real estate valuation for tax purposes is performed in accordance with the Law on Estimation of Real Property Taxation in Kosovo. According to chapter 2, section 12 of the Law on Estimation of Property Taxation in Kosovo, each municipality is responsible to value the property and re-evaluate the property every three to five years. Section 12.1 of the present law provides that the Ministry of Economy and Finance through an administrative directive will describe the uniform valuation standards. These standards will include: income from property, building cost, location, area and property conditions.

The capital Prishtina uses the Directive on real property taxation. According to this directive, the Municipality of Prishtina is divided in 5 taxation zones: - Prishtina City is divided in three taxation zones, each of them in two categories (category -I- and category -II-), whereas the villages around Prishtina Municipality in two other taxation zones. According to this regulation each property has a certain value for meter square in different zones, by multiplying it with the area of the property gives the market value of the property and then the coefficient decides what will be the tax value that the owner will pay. The valuation of properties and the identification of taxor are done by people working in the Unit of Property Taxation and Cadastre and Geodesy. If the owner thinks that the market value of the property is not determined correctly, he/she has the right to require from the Directorate of the Property Tax to re-evaluate the property and in cases of damages, or improvements in the property.

Second, the real estate valuation for commercial purposes is rarely used because the property transactions are conducted privately through an agreement between the seller and the buyer, mainly by using the comparable sales approach whereby the seller sets the price by comparing with other properties in the region. If the transaction is made through any real estate agency and the valuation is required from any of parties in process, and most of the time comparable sales method is used. Currently, in Kosovo

there are no licensed or certified real estate appraisers. From the structured interviews with so called property valuers the need for a greater government control in this field is obvious. In addition to this, commercial banks use real estate valuation for lending purposes. From the structured interviewed with bank risk officers it is obvious that several banks in Kosovo have a very high standard in property valuation, whereas others use only comparable sales method and the sense and their valuation reports are quite simple and non-professional.⁷

Unlike most of the banks, Raiffeisen Bank Kosovo performs the real estate valuation in accordance with international valuation standards. Raiffeisen Bank Kosovo performs the valuation in accordance with the special directive issued by Raiffeisen International in Vienna, according to which three standard real estate valuation approaches are used: comparable sales approach, income approach and cost approach depending on the property.⁸ Banks in Kosovo take into account the following characteristics such as location, physical characteristics, and legal aspects. Nevertheless as bank officers argue the lack of credible data is one of the problems that the valuers are facing very often in these banks.

Third, the real estate valuation in Kosovo is also performed for expropriation purposes. Valuation of the property for compensation from expropriation requires the most detailed valuation, because the surrender party in this case is never satisfied with the compensated amount and needs a lot of explanations why and how the property is valued. The legal framework regulating the valuation for expropriation purposes is the Law on Expropriation of Immovable Property, approved in March 2009 by Kosovo Parliament. Article 21 of the present law provides that the Ministry of Economy and Finance shall establish, within its Department of Property Tax, an Office of Immovable Property Valuation which shall be the competent public authority for valuing any immovable property that is subject to an expropriation procedure by any Expropriating Authority.

Real Estate Valuation methods used in Kosovo and usage of GIS

As Triphonov argues there are three methods, which are most commonly used in transition economies: comparative approach,

⁷ S. Sherifi, *Interview, Nova Ljubljanska Banka, Prishtina, Kosovo, 2010.*

⁸ I. Rexhepi, *Interview, Raiffaisen Bank, Prishtina, Kosovo, 2010.*

cost approach, and income approach.⁹ The most commonly used method in Kosovo is the sales comparison, which method is based on the recent sales of comparable properties, and their comparison with the property being appraised. The proper use of this approach requires good knowledge of the subject property, city and region where it is located.¹⁰ It is usually used in the residential housing market. The sales comparison approach is used by both private parties during the sales transaction and bank risk officers. The use of comparable sales method entails finding comparables in a particular area. Using GIS system would be of importance in this regard. GIS software and GIS collected data can be very useful in identifying appropriate comparables. Using the GIS system, the appraiser can display a map, which will show all the recent sales. As Castle argues by using GIS, the appraiser can see the attributes of the sold property and see whether the sold property can be a reliable comparison to the appraised property.¹¹ Nevertheless this valuation method in Kosovo is highly influenced by social factors such as relationship between the seller and the buyer in the form of family or collegial relationship, which makes the values of such purchased properties not a true reflection of what exists in an open market and makes the comparable sales approach more difficult.

The cost approach requires an estimate of construction costs, because the value of property is defined for this purpose as the sum of the land value and the depreciated cost of the improvement.¹² It is based in the concept of substitution, which means that calculations have to be made like the identical building is to be build and subtract the possible decreases in the value, because of the age of the building. It is mostly used when a unique type of property is valued, like school, church, mosque, government buildings and so forth, in these cases it can be the only method that can be used. However, this approach has challenges in implementation in Kosovo due to the fact that data on local construction costs are lacking and in vast majority of the cases construction operations are paid in cash in Kosovo. Nevertheless since Kosovo uses Euro and has a stable inflation, stable inflation causes stable

⁹ N. Triphonov (footnote nr. 2), p. 134.

¹⁰ R. Betts and S. Ely (footnote nr. 5), p. 165.

¹¹ G. Castle, 'GIS in Property Valuation-What is worth?', *BG*, 1993, 1, p. 24.

¹² R. Betts and S. Ely (footnote nr. 5), p. 244.

cost of building materials and makes it easier to analyze and use the cost method of valuations with any degree of certainty.

The income valuation approach is used less in Kosovo, with exception to Raiffeisen Bank Kosovo, which uses this valuation based on the type of property and the usage of property for rent.¹³ In income valuation approach macro-economic data are used which are more difficult to be found in Kosovo. This method is less used in Kosovo because in the income valuation method the data that are to be used, which are taken from the rental contracts, ownership documents, or other documents from the owner, vacancy percentage, are not available because the clients in Kosovo own both commercial and residential properties with less market-based transactional evidence.

Challenges and constraints in real estate valuation are inherent in human element, which is deficient in skills and methodology of work, while the system itself relies upon bad surveying data and bad statistical input. Whereas the sales comparison method, as the only method used for valuation and assessment in Kosovo, results are poor because of limited outreach, such as cases with missing sales contracts in rural areas (more than 50% of Kosovo is rural) and other problems such as the lack of sales profit tax, sales prices underreported in contracts and flourishing black market of property sale.¹⁴

The sources of data used for valuation in Kosovo

For the possible changes among subject and comparable properties, the adjustment is required. These adjustments are made based on location or time of transaction. With regards to location, adjustments are made by a field visit and comparing the difference from the city centre or main road, whereby in terms of time of transaction the adjustments are made by using Real Estate Price Index or Consumer Price Index. The Consumer Price Index is measured from Statistical Office of Kosovo and is published every month¹⁵, while the Real Estate Price Index is not measured yet in Kosovo.

¹³ I. Rexhepi (footnote nr. 8).

¹⁴ S. Fannberg and U. Mathiasson, *Property Tax in Kosovo, Inception Report, Prishtina, 2008*,

¹⁵ www.ksgov.net/ESK/eng/index.php?option=com_docman&task=cat_view&Itemid=8&gid=26 (accessed: 21. 4. 2013).

One of the most credible sources for valuation is Land Information System, which is a project financed by Swedish International Development Agency (SIDA) in Kosovo Cadastral Agency. It integrates the textual and graphical data in a central database and it has a unified connection for users. The users have no other limits for access in the data except specific rights for access. KCLIS program is based on Web and fulfills all the necessary standards, therefore the information can be used from more applicants in internet.¹⁶

Second source of data for valuation used in Kosovo is real estate agencies, which can be a good source of information for property valuation, because they possess numbers of contracts made from transactions. In these contracts we can find all necessary information: the category of the property, location of the property, date of transactions, purchase price and so forth.

The final source of data for valuation, in particular of residential properties is the weekly newspaper “Oferta Suksesi”, which possesses information on residential properties.

Constraints of real estate valuation in Kosovo

There are several constraints that affect professionalism and credibility of real estate valuation in Kosovo: a) lack of credible data; b) lack of developed property market; c) variances in demand; d) social factors; and e) lack of spatial planning regulations, knowledge, and implementation.

First, an essential factor that affects the open market valuation of real estate is the lack of credible data. This factor is problematic in use of all real estate valuation methods and also of comparable sales method, which is the most frequently used method in Kosovo. The mechanisms for collection of property data and information are weak and they do not provide credible information on which the real estate appraiser can rely before rendering an informed opinion regarding property values. Apart from a very few well established real estate agencies and organizations, which maintain some data, it is extremely difficult to find formally structured data necessary for real estate valuation. Despite of this, the data that are maintained by these private real estate agencies are

¹⁶ www.kca-ks.org/english/news/fs_news.html (accessed 20. 4. 2013).

not formally maintained because many contracts are concluded below the market value in order to avoid the property income tax and it is also difficult to access these data because of business secrecy and desire by these firms to protect their clients in Kosovo's transitional economy.

Second, in Kosovo the real estate market is not very well developed in terms of transfer of property ownership. Although the free trading with real estate takes place in Kosovo, many real estate transactions are recorded in court below the market value to avoid property income taxes and knowledge about the property market is limited and fragmented. There is no legal framework on real estate trading. Buyers and sellers therefore act in their own way. To this end, there is also no clear legal framework of property values which are often subject to the whims of the people involved in the transactions and each property is to a large extent traded on its own merit under its particular circumstances. Most property owners determine their own terms and conditions without reference to established formal guidelines on property values or valuation principles.

Third, another factor that poses a constraint in the valuation of real estate is the variation of demand for properties especially residential properties because of Kosovo Diaspora that dictates the market of residential properties in the urban area of capital of Kosovo. Often the value of real estate is arbitrarily decided between the parties and the payment for the property is not subject to any valuation methods or principles.

Fourth, the relationship between the parties in many cases greatly affects negotiation of the price/value of properties. Since Kosovo society is close knit society most people in Kosovo have relationships and strongest relationships are family ones. The value of properties purchased under such circumstance is therefore not a true reflection of what persist on the open market. In addition to this, most people in Kosovo see the purchase of properties especially for residential purposes as more of a prestige rather than investment. The thrill to purchase property is therefore not driven by investment but social recognition and personal satisfaction.

Fifth, the lack of well defined spatial planning and urban design regulations limit the adequate use of real estate valuation methods. Also, even the use of comparable sales method

of valuation is problematic because many buildings are unique because they are constructed according to the taste and requirements of the owner and not according to an urban regulation plan.

Finally, due to earlier stated factors which play a major role in real estate valuation, the valuation profession becomes not only challenging but also loses confidence in the eyes of general public. It would therefore be practical to minimize valuation difficulties by improving data quality and create a reliable real estate data system to provide uniformity and clarity in the open market value for the real estate market.

Intentions to build a better valuation system in Kosovo

Due to difficulties stated earlier, authorities in Kosovo have made concerted efforts to build a better real estate valuation system. During the year 2009, the Ministry of Economy and Finance as an institution entitled for collection of property taxes, published an international tender to establish a Valuation Office in Prishtina, which would observe the International Standards of Valuation. The main reason for this is the adoption of the Law on Expropriation of Republic of Kosovo. Kosovo Appraisers Association has been established in August 2009 to establish appraisal standards and prepare individuals through education for sitting a license examination, which will be prepared in the future and increase the overall level of professionalism in the appraisal sector in Kosovo.¹⁷ The Kosovo Cadastral Agency has intentions to train its employee in property valuation and to develop the part of Valuation in Kosovo Cadastral Land Information System for better use of property data from its clients. Gashi from the Real Estate Appraisers Association of Kosovo argues that the actual system of real estate valuation in Kosovo is centered at the Ministry of Finance and Economy and in the current form of organization does not support the transition of real estate valuation to a better system which would contribute to the better market economy in Kosovo.¹⁸

¹⁷ www.tegova.org/en/p4b0675ffb7725 (accessed: 19. 4. 2013).

¹⁸ A. Gashi, Interview, Association of Real Estate Appraisers of Kosovo, Prishtina, Kosovo, 2010.

As it was mentioned earlier the lack of credible and adequate data makes the real estate valuation a challenging and untrusting profession. Thus, the authorities are making efforts to establish a property data system that would come from three sources: Kosovo Cadastral Land Information System, Immovable Property Rights Register, and WebGIS Kosovo. KCLIS is a project financed by Swedish International Development Agency (SIDA) in Kosovo Cadastral Agency. It integrates the textual and graphical data in a central database and it has a unified connection for users. The users have no other limits for access to data except for specific rights for access. KCLIS program is Web-based and fulfills all the necessary standards, which makes possible for more than one applicant to access this data on internet.¹⁹ On the other hand **Web-GIS Kosovo** is a project for the development and implementation of a Web-based distribution system for cadastral information. The Project has been developed during the Kosovo Cadastral Support Program but it is not fully operational due to technical difficulties and due to the fact that only information from few cadastral zones have been included in Web-GIS system.

Conclusion

In conclusion, as examined in this paper there are many aspects of real estate valuation that will need to be implemented in Kosovo. The fundamental change that needs to happen is to establish a database of adequate information of each real estate property and transaction. This database would contain credible information on selling/purchase price, the characteristics that affected the property value, rent contracts, and other important information.

Furthermore the law that regulates the real estate needs to be amended in order to make it mandatory for the real estate owners to register the actual real estate price in order to have real comparative statistics. One way to address this issue would be for the law to provide that the income the real estate owner receives from selling the property is taxable according to applicable rate. However, if there is a case that the property owner reports lower income from selling the property in order to avoid taxes, then the

¹⁹ www.kca-ks.org/english/news/fs_news.html (accessed 20. 4. 2013).

law should ensure that when the buyer registers the purchased property below the market value, than the difference of the price according to the market value should be taxed as a gift. This provision in the law would ensure that both the seller and buyer report accurate prices of their properties since they are both unwilling to pay a higher tax due to the underreporting of market price. There are other issues that affect real estate valuation in Kosovo, but these mentioned in conclusion are the ones with priority.

