The Impact of the 2021 Civil Unrest on the Recurrent Property Tax in South Africa's KwaZulu-Natal Province

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Authors' note: *This paper is based on Janet Channing's paper "Unrest and Looting: Revaluation Dilemmas," presented at the International Property Tax Institute and International Association of Assessing Officer's Mass Appraisal Valuation Symposium Applications and Challenges, held virtually June 22-23, 2022.*

Abstract

The devastating civil unrest experienced in July 2021 in especially KwaZulu-Natal, South Africa, not only affected more than 40,000 businesses, but also had a direct impact on the collection and administration of the recurrent property tax (called "property rates"). This paper considers policy recommendations for supplementary valuations and rates relief for affected property owners and debates the implementation options available to municipalities.

Introduction and Background

In July 2021, South Africa experienced a devastating week of civil unrest, rioting and looting in three provinces, namely KwaZulu-Natal (KZN), Gauteng, and Mpumalanga. These events were purportedly caused by the incarceration of the former president of the country, Jacob Zuma, after he was found guilty of contempt of court. The unrest was coordinated through social media mobilization leading to the disruption of economic activity, looting, and the destruction of property. An early online survey conducted by the national government Department of Trade, Industry and Competition (DTIC) estimated "that the unrest had affected 991 businesses, had caused damages worth R5.8 billion, and threatened up to 10,373 jobs. It also reported on potential long- and short-term economic

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impacts of the unrest" (PMG 2021). The Expert Panel Report, published in November 2021, describes the event as an "orgy of violence" that left 354 dead (Expert Panel Report 2021:35) and according to the Consumer Goods Council of South Africa (2021), ZAR 50 billion lost to the economy.

Depending on various factors, such as the extent of damage, access to capital, and business prospects, the pace of recovery will vary. Of the non-insured businesses surveyed by the DTIC, 63 percent indicated that they expected to resume their operations within three months whereas for insured business it was 74 percent (PMG 2021). The national government announced a support package consisting of various measures, including deferral of Pay-as-You-Earn (i.e., income tax) and excise duties for qualifying companies (PNG 2021). Municipalities also announced property tax relief measures to assist property owners affected by the destruction and damage to their properties. These events occurred at a time when municipalities and taxpayers were already dealing with the adverse financial and fiscal impact of the Covid-19 pandemic.

In this paper we focus on the impact of the civil unrest and destruction of or damage to property on the administration of and revenue from the recurrent property tax (referred to as "property rates" in South Africa), especially in KZN. We consider policy recommendations for rates relief for affected property owners and debate the options for implementation by municipalities. Through reviewing various valuation approaches adopted to determine values of totally and partially destroyed buildings, we develop recommendations for both the valuation profession and local government. First, however, it is necessary to provide some context on the importance of property rates as source of revenue for South African municipalities.

Importance of Property Rates as a Source of Revenue for Local Government

Section 229(1) of the Constitution of the Republic of South Africa, 1996, guarantees property rates as a source of own revenue for municipalities, the third tier of government. Property rates is levied and collected in terms of the Local Government: Municipal Property Rates Act 6 of 2004 (hereinafter "MPRA"). It is the most important local tax levied and collected in South Africa and payable by the owners of immovable property, that is real estate (Franzsen 2017). The contribution of property rates to the total income received across all 257 of South Africa's municipalities is 18.3 percent (Statistics SA, June 2019). It is especially important for the eight metropolitan municipalities as well as the secondary cities, referred to as B1 and B2 local municipalities (Stats SA 2021a). Even for B3 and B4 local municipalities that are rural, generally sparsely populated, and mostly reliant on intergovernmental transfers, property rates still constitutes an important source of own revenue.

Municipal Rating Environment in South Africa

The tax base for property rates is "market value." Market value is defined in section 46(1) as the "amount the property would have realized if sold on the date of valuation in the open market by a willing seller to a willing buyer." The market value of properties must be determined by a designated municipal valuer – who can either be an in-house valuer (i.e., an employee of the relevant municipality) or – more commonly – a private sector service provider appointed by the relevant municipal council in terms of an open bidding process. In terms of section 31(1) of the MPRA, the "date of valuation" is adopted by the respective municipal councils as a date within 12 months of the implementation date of the general valuation roll.

The designated municipal valuer is responsible for both assigning properties, based on their actual use, to the category of property and the determination of market value for each property record within the municipal jurisdiction. The MPRA provides for differential rating whereby the various property use categories attract different rates or tariffs. The amount of rates payable by the owner to the municipality is calculated by multiplying the market value of the subject property by the differential tariff, expressed as an amount in the Rand (ZAR), for that specific category of property.

According to section 3(1) of the MPRA, a municipality is required to draft a "property rates policy" consistent with this Act on the levying of rates on ratable property in the municipality. Section 5(1) provides that this policy must be reviewed annually. To give effect to the rates policy, it must be adopted as a rates policy by-law (s 6). The rates policy must, amongst other things, define the criteria applied by the municipality for the provision of rates relief. Rates relief may be extended as a rebate (discount), a reduction (monetary reduction off the market value), or an exemption to a category of property or to a category of owner of property. Furthermore, section 17 of the MPRA also provides for certain properties to be excluded from rates, in other words where it is impermissible for a municipality to levy a rate.

Under section 15(1) of the MPRA, a municipality may, in terms of criteria set out in its rates policy, :

(a) exempt a specific category of owners of properties, or the owners of a specific category of properties, from payment of a rate levied on their property; or

(b) grant to a specific category of owners of properties, or to the owners of a specific category of properties, a rebate on or a reduction in the rates payable in respect of their properties.

Where the rates relief is granted to owners of a category of property (i.e., the focus is on property categories), the property use categories prescribed in section 8 are important. Where the rates relief is granted to a category of owner of property, the closed list of categories of owner in section 15(2) is important. Section 15(2)(a)-(f) provides for the following categories of owner:

(a) Indigent owners;

(b) owners, dependent on pensions and social grants;

(c) owners temporarily without income;

(d) owners within –

  (i) a disaster area (within the meaning of the Disaster Management Act, 2002 (Act No. 57 of 2002); or

  (ii) any other serious adverse social or economic conditions;

(e) owners with a residential property lower than an amount determined by the municipality; and

(f) owners of agricultural properties who are bona fide farmers.

In respect of part (f), supporting documentation may include an IT34A certificate issued by the South African Revenue Service and/or an affidavit from the owner that the property is used primarily for agricultural use. Section 3(6) explicitly states that a "municipality may not grant relief to the owners of properties on an individual basis."

Impact of the Unrest on Municipal Property Rates

In KZN the two municipalities most affected by the unrest were the eThekweni Metropolitan Municipality and the Msunduzi Local Municipality, the two largest municipalities in the province. In terms of the Local Government: Municipal Structures Act 118 of 1998 (read with s 155(1) of the Constitution of the Republic of South Africa, 1996), eThekwini is a Category A municipality and Msunduzi is a Category B municipality. Msunduzi is further classified as a B1 municipality, that is a secondary city. A number of other local municipalities also experienced looting and business closures, as well as damage to immovable property. In this paper, these smaller municipalities are only referred to in passing.

The South African Property Owners Association (SAPOA) estimated that 3,881 stores had been affected by the unrest (PMG 2021). In KZN, the destruction or serious damage affected 2,377 retail stores and 79 shopping centers. In Gauteng, 1,468 retail stores and 30 shopping centers were destroyed or damaged and in Mpumalanga damages to 86 retail stores and 3 shopping centers were reported (SAPOA 2021). More than 40,000 businesses were affected in KZN with the provincial losses to gross domestic product (GDP) estimated at over ZAR 20 billion (SAPOA 2021; PMG 2021). From the above figures it is evident that the impact of the civil unrest was particularly noticeable in KZN. On 29 July 2021 (Daily News, IOL Reporter, 29 July 2021), immediately after the events, the Premier of KZN declared the province a disaster area. This declaration, however, was not officially published in the Provincial Gazette.

In the next section we review the two markedly different approaches taken to extend tax relief in respect of properties affected by the looting and destruction as implemented by eThekweni Metropolitan Municipality and Msunduzi Local Municipality respectively.

Option 1: Rebates to Category of Owners of Property

The eThekweni Metro Municipality extended immediate property rates relief to categories of owners of property affected by the unrest in terms of section 15(2)(d)(ii) of the MPRA, in other words for owners affected by "serious adverse, social and economic conditions." At a full council meeting held on August 5, 2021, the eThekweni Council adopted rates relief of up to 75 percent (eThekweni Municipality Press Release on August 10, 2021). A rebate of 75 percent was extended to buildings that were non-functional because of the unrest for a period of six to twelve months. Statutory relief was also extended to streamline the restoration of damaged buildings. Using the relief provisions contained in the property rates policy the metropolitan municipality communicated that affected property owners may approach the council to apply for relief in respect of their damaged properties. A total of 750 applications were received.

Challenges included accommodating owners who missed the initial 60-day cut off. These owners were re-directed to apply for a supplementary valuation in terms of section 78. This provision allows for a revaluation where a property has increased or decreased in value since the date of the last general valuation, in the case of eThekweni this date was July 2018. The normal fees raised by the City for the application for a re-valuation were waived. Certain owners applied for both the 75 percent rebate as well as the reduction, this double relief was disallowed. If a property was completely destroyed the value was adjusted to vacant land. However, the zoning of the property was retained to save the owner the rezoning fees, a further extension of relief.

The rates relief was extended on a phased basis with the City's immediate extension as a rebate for an initial six- to twelve-month period following the unrest. Once the City's

Valuation Department reviewed the actual damages, the adjustments to the property's valuation were assessed. The revaluations or supplementary valuations were based on the actual damages sustained and the extent of the property that was considered still operational. The City's valuers undertook inspections of the affected properties and assessed the area of the Gross Building Area (GBA) that was, in their opinion, still operational. Once the buildings are repaired or reinstated; these properties would need to be re-assessed through a further supplementary valuation.

Option 2: Supplementary Valuations

The MPRA, section 78(1)(d) states that a municipality must prepare a supplementary valuation where there has been a significant increase or decrease in the market value of the property since the last general valuation. In other words, section 78(1)(d) may be applied where a property is damaged or destroyed with a concomitant reduction in the market value. The decrease in value should be reflected in a supplementary valuation. The registered owners are extended reduced rates liability through the lowered property values from the date that the damage was incurred.

In the case of Msunduzi Municipality, the city opted to assess the decreased value of the properties affected by the July 2021 unrest. The adjusted rates from these revaluations per property are calculated from the date of the unrest event, in other words July 12, 2021. The municipality requested its Valuations Department to prepare supplementary valuations for all properties affected by the unrest. An issue that immediately arose, however, was how to quantify the damages to buildings. Some buildings were completely destroyed (100%), while others experienced only partial damage. The municipal valuer was required to prepare a supplementary valuation in all instances on the following basis:

- Where the property was totally damaged (i.e., the buildings were completely destroyed), the property was revalued as vacant land; and
- Where the property was only partially damaged, the property value was adjusted to reflect the costs of reinstatement of the damaged part of the property.

Council adopted a retrospective resolution regarding rates relief extended through lowering the value of the affected properties through the preparation of supplementary valuations. There was an awareness campaign, including a front-page article in The Witness, a widely-read provincial newspaper. The municipal website published a notice with a link to a digital survey form that affected property owners were urged to complete. Council also adopted an adjusted budget that took the impact of the rates relief (or lowered rates revenue) into consideration.

Section 78(5)(a) of the MPRA provides for notices to be sent by the municipal valuer to the respective property owners advising them of the revaluation. The property owner may lodge a request for a review within 30 days of the posting of the notice. The municipal valuer may adjust the supplementary valuation on consideration of the review (section 78(5)(c)). Once this process is concluded the supplementary valuations are uploaded to the financial system for billing purposes.

According to section 78(6), a municipality is required, once a year, to compile and publish a supplementary valuation roll for all the supplementary valuations prepared during the financial year. Section 49 media notices advise the public of the publication of the supplementary valuation roll and dedicated notices with the extracts of the published valuation roll are sent to all affected property owners. Affected property owners as well as any interested parties have recourse to lodge an objection against any information included in or omitted from the valuation roll. The municipal valuer must review the objection applications promptly and communicate the outcome of the objection reviews to the property owners and the objectors if the property owner is not the objector. Should the objector be dissatisfied with the outcome of the objection review they may appeal against this review decision through lodging an appeal application. Appeal applications are heard by a valuation appeal board and each case is considered on its own merit.

Similar to Msunduzi Local Municipality in KZN, the City of Johannesburg in Gauteng also opted to provide rates relief to affected property owners through preparing supplementary valuations. On July 21, 2021, the City of Johannesburg issued a media statement acknowledging the impact of the looting incidents on property owners in the city (City of Johannesburg 2021). The city advised that they would consider the extent of the damages as well as the estimated time it may take for repairs to be effected. Property owners were requested to cooperate-operate in assisting the municipal valuers in their assessments. Of course, the damages relevant in the context of property rates are those that relate to the structure of the building. An inspection was undertaken by the city's in-house valuation staff to establish the extent of the damage and the estimated cost to repair. Once the repairs have been completed, the property will be revalued again (City of Johannesburg 2021).

Procedures for Preparing Supplementary Valuations

To acquire the details of the damages to immovable property Msunduzi Local Municipality extended a digital questionnaire to all property owners across the city. Affected property owners were invited to submit their estimation of the extent of the damages as a percentage with supporting photographs, insurance claims, a cost estimate of the damages (where available), estimated time frames to reinstate the property and time frames to re-commence business activities. A quantity surveyor and structural engineer were employed specifically to support the Valuation and Rates Department's preparation of supplementary valuations.

Many property owners also received immediate relief from the South African Special Risks Insurance Association (SASRIA) as well as through the short-term insurance companies with whom they had insurance cover. SASRIA provides specialized insurance cover to property owners against risks such as terrorism, civil commotion, public disorder, strikes, and riots. SASRIA received an unprecedented number of claims – more than 14,000 (Expert Panel Report 2021: 77).

There was some confusion regarding the various relief initiatives provided by the different business units within the Msunduzi Local Municipality. The Local Economic Development (LED) Business Unit focused on capturing data about losses of movables, such as vehicles, stock, and equipment (i.e., personal property) in collaboration with the government's Department of Trade and Industry (DTI). Certain grants were extended to businesses that experienced inventory, stock, and vehicle losses. The communications regarding the various relief initiatives were uncoordinated leading to confusion within the community. Generally, business owners in the informal sectors were not afforded any of these relief options and many of them also had no short-term insurance cover.

Duration of the Impact of the Unrest

In quantifying the impact on the revenue foregone through the rates relief, the duration of the impact needed to be quantified. Of the 720 businesses that participated in the eThekweni survey 70.7 percent of the respondents indicated that their businesses would re-open. A further 26 percent estimated that their businesses would be able to recommence operations within 6 months of the events. By December 2021, the most severely impacted businesses had reduced to only 14.4 percent of the city's business sector. In April 2022, the city's revenue manager, Khanyi Gama, indicated that the city processed ZAR 14 million rates relief for riot-related damages to property and that the Valuations Department is currently addressing queries from property owners who were unsuccessful in obtaining this relief. At that time (April 2022), reviews for related supplementary valuations were still underway (Gama 2022).

The project team assigned to do the data analysis for the Msunduzi Local Municipality divided the reinstatement periods into two branches, namely: (1) properties that were likely to be reinstated by October 2021 (an assumption on the basis that these properties suffered damages amounting to less than 40 percent of the property value); and (2) properties that suffered more extensive damage (i.e., more than 40%) and therefore were only likely to be reinstated by January 2022. These properties were subject to review and further consideration by the City's Valuation and Rating Department.

The City's Valuation and Rating Department is required to review these damage and reinstatement schedules periodically. Upon completion of the reinstatement, these properties will require a further supplementary revaluation in terms of section 78(1)(d) of the MPRA – this time round the revaluation is on the basis of a substantial increase in market value. In each instance the revaluations must reflect the market values of the respective buildings as at the date of valuation of the general valuation roll (section 78(3)).

The reinstatement time frames are conditional upon the commencement date of the respective building projects. With the delays, either through the delayed return of insurance assessments, the final pay-outs from the insurance claims, or SASRIA pay-outs, these periods may be longer than initially estimated.

Although only 110 property owners in the Msunduzi Local Municipality reported damages, most of the affected properties were high value. The net impact on the city's revenue was therefore proportionately more than anticipated on a straight-line percentage basis. The properties damaged in the civil unrest constituted a mere 2.2 percent of the total number of properties in the city's valuation roll however the revenue loss of 5.3 percent of the municipality's rates revenue was calculated. The rates revenue foregone for the initial eight-month period following the unrest was an estimated ZAR20 million. Most of the properties achieved the reinstatement within the eight-month period. Twelve months later, July 2022, the City's consolidated valuation roll has still not regained the pre-July 2021 asset value. This despite new properties being added to the valuation roll during the normal course of the City's development.

According to Rakesh Ramgoolan of the City Valuation Department, data to illustrate the net impact of the civil unrest on the eThekweni rates revenue is unavailable. The metro implemented a new general valuation roll from 1st July 2022. This roll's valuation date is July 1, 2021 as opposed to the previous general valuation roll's valuation date, July 2017. The variance in the valuation dates makes the comparison unrealistic.

Valuation Challenges

During the July 2021 unrest, properties were either completely or partially damaged. In the case of properties where buildings were completely destroyed, the buildings require complete reinstatement. These properties are considered vacant land until the reinstatement is completed. The situation is akin to a new building being built on vacant land. A more challenging issue is the adjusted value determination for properties where buildings and other improvements are only partially damaged. Under normal circumstances, the market value determination of commercial and industrial properties is achieved through an income approach, where the value of an asset is determined by reference to the value of the income, cash flow or cost savings generated by the asset (S 40, IVSC, 105, January 31, 2022). These standards state that the basis of the income approach is that investors expect a return on their investment and the determination of this return should take the perceived level of risk into account. The capitalization rates (cap rate) in real estate refers to the rate of return from a property based upon the net operating income of the property. The capitalization rate is calculated using the current market prices of a property over a specific period. If the market is stable the cap rates will remain the same. If the market values rise or fall the cap rates are subject to change. The determination of an appropriate cap rate is subject to the type of asset being valued, the rates implicit in comparable transactions within the market, the location of the markets as well as the lifetime and/or maturity of the asset (S 50, IVSC, 105, January 31, 2022).

The July 2021 unrest specifically targeted commercial and industrial properties. Municipal valuers will have used the income approach, with few exceptions, to value business and industrial properties. Valuation inputs are primarily rentals, operating expenses, and the market capitalization rates. The dilemma is that there is no market evidence of any of these inputs for partially damaged buildings. Thus, no market benchmarks were available to the valuers when they were preparing adjusted market values for purposes of supplementary valuation rolls. In the case of eThekweni, the valuers estimated the portions of the gross building areas that were still operational. This approach determined the adjusted or decreased values of the affected properties. This can only be a proxy for market value. We contend that a willing buyer would not view a 50 percent intact shopping center as being worth half the value of the intact and fully functioning facility. Although this approach may provide a starting point, an adjusted value determined in this manner should not be equated with market value.

For the purposes of these supplementary assessments, the adjusted property value cannot be viewed as "market value." It is the market value of the property as determined on the date of valuation (different for each local authority) less the estimated cost of reinstatement, or, in the case of eThekweni, the market value less the value of the apportioned gross building area that was destroyed. There are no reliable benchmarks for either the apportioned gross building area adjustments nor the market value less the reinstatement values as proxies for adjusted "market values." These 'values' are hypothetical adjustments to enable the city's valuers to extend temporary rates relief to property owners adversely affected by the unrest and destruction.

A case study of property previously used for storage facilities indicates that while the property owner may reinstate the property to its former land use there may no longer be a market for storage facilities within this specific area. In this specific instance, the subject area is now perceived as too vulnerable for this specific land use. This means that the property owner has incurred more damage than just the cost of reinstatement. The market value of this property has significantly altered. An undetermined period will have to lapse before the revised market value may be accurately ascertained. These exceptions need to be recognized by municipal valuers and in-house valuation departments.

The findings of the impact study included a large number of properties where the reinstatement costs are higher than the market value reflected in the valuation roll. In the Msunduzi sample of 110 properties, 57 properties (i.e., 52%) have a reinstatement cost greater than their 2019 market value, the valuation date for the current valuation roll. This is an indication of the age of the buildings, the high costs of reinstatement as well as the material loss these property owners suffered due to the July 2021 unrest. The estimated costs of reinstatement for the 110 affected properties in Msunduzi is ZAR 2 billion.

Conclusions and Recommendations

At the end of August 2021 (i.e., more than a month after the unrest), the provincial Department of Co-operative Government and Traditional Affairs in KZN issued a circular (CoGTA-KZN 2021). The advice included the requirement for a municipality to prepare and table a "first" report to council outlining the broad impacts, legislative / policy provisions, and the mechanisms / application process for considering and applying property rates relief. Few municipalities followed the guidance as the circular was issued long after a response was required, a case of 'too little, too late'.

The experience from the July 2021 unrest is that the most efficient way for municipalities to engage proactively with affected property owners through digital surveys and questionnaires. These should be made available immediately to all affected property owners through municipal websites and social media platforms. Property owners' applications for rates relief must be supported by photographs, building plans, engineers' reports, as well as insurance claims. The council resolutions adopting measures to extend relief to affected properties and distressed property owners should be swift.

In terms of section 23 of the MPRA, every municipality is required to establish and maintain a municipal register of properties. All data about the damaged properties should be captured into this geospatial data base for ease of reference and transparency. The resultant data base enables interested parties to gain an overall view of the total impact of the event or events that resulted in loss and damage. This spatial data base enables a municipality to take informed decisions about future planning and remedial actions. If the municipality does not have a spatial municipal register of properties or if this register is not current and complete the municipality's capacity to make informed decisions regarding their response to this and similar future adverse conditions is compromised.

Except for eThekweni, all affected municipal councils in KZN as well as the City of Johannesburg (Gauteng Province) opted to extend property rates relief through the preparation of supplementary valuations rather than extend immediate relief through a rebate or discount to affected property owners.

Section 78(1)(d) of the MPRA states that a municipality must cause a supplementary valuation to be prepared in respect of any ratable property where the market value has substantially increased or decreased for any reason after the last general valuation. There is, however, no emerging consensus on a consistent valuation approach to establish the decreased market value. The two approaches discussed above include: the apportioned value of the remaining gross building area or the market value as reflected in the valuation roll less the estimated reinstatement costs for the incurred damages to the properties. Both these approaches raise queries regarding their reflection of "market value" as prescribed by the legislative framework, the MPRA. The adjusted values are useful as interim measures for extending relief to the owners of partially destroyed or damaged properties. These values remain hypothetical adjusted values that do not equate to "market value."

It is likely that occurrences of this nature may happen again in South Africa and elsewhere across the globe. Terrifying as it is to contemplate a recurrence of the events of July 2021, the question of whether local government, municipal valuers specifically and the valuers' profession more generally are now better equipped to manage future events of this nature and magnitude. Certainly, the questions we raise in this paper, both procedural and regarding the most appropriate valuation approach, highlight some of the issues that ought to be addressed. The unfortunate events of July 2021 should be viewed as a wake-up call. An alert for both the valuation profession and local government to engage proactively towards developing a set of guidelines that are available to be implemented in the future.

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