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Is The Amount of Compensation for Real Estate Expropriation Just? Current State and Proposals for Changes

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Abstract: *Payment of compensation for expropriated real estate in Poland is guaranteed by the Constitution of the Republic of Poland. It contains a provision stating that the compensation for the compulsory purchase of real estate has to be just.*

The amount of the compensation is established by certified real estate appraisers. Real estate appraisal is governed by the provisions of the law of real estate management. As a matter of principle, the value of a real estate is established for current or alternative use, the latter concerning the use of the real estate after expropriation. In many cases, the owners of expropriated real estate feel aggrieved.

This is because the legal provisions concerning the manner of calculation of compensations do not take into account other circumstances, which cause the deterioration of economic conditions and the change of social environment for the owners of the expropriated property.

This paper presents the current state of calculation of compensation due in relation to real estate appropriation. It also presents a proposed broader look at the compensation for real estate expropriation. It suggests the need to improve the provisions of law and methods of real estate valuation in order to protect rights to the property in a better way.

Keywords: *expropriation, compensation, real estate valuation*

1 Introduction

In most countries, the principle of compensation for real estate expropriation is guaranteed in constitutional regulations. The principle is also guaranteed by The Constitution of the Republic of Poland 2 April 1997. Article 21 of the Constitution states that expropriation is allowed solely for public purposes and that just compensation should be paid. Just (equitable) compensation means compensation corresponding to the market value of the property.

The legal act which regulates real estate matters is the law dated 21 August 1997 regarding real estate management. It provides legal procedures for expropriation and indicated methods of calculating the amount of compensation for expropriated real estates or for the expropriation of titles to the real estate other than ownership.

Detailed principles of real estate appraisal are provided in executive regulations to the law – The Directive of the Cabinet dated 21 September 2004 regarding real estate valuation and preparing the appraisal study.

Real estate may be appraised exclusively by certified real estate valuers. Certifications to do this are granted by the relevant minister who deals with matters related to construction, architecture and spatial management. At present, this is the Minister of Construction.

Compensation should be calculated in the form of a cash amount. Damage compensation in a different form, e.g. by granting the expropriated person another substitute real estate is only permissible with their consent. In such a case, what needs to be established are the values of both the expropriated real estates and that offered in exchange.

2 General principles of the assessment of compensation for real estate expropriation

Compensation for expropriation of real estate is reserved to real estate owners, holders of perpetual usufruct of land and holders of other legal interests in land. The amount of compensation is determined by a county head in a decision regarding real estate expropriation once an opinion regarding the value of the real estate has been provided by a real estate valuer (Real Estate Management Act). In practice the expropriated person, nevertheless do not accept the amount of compensation.

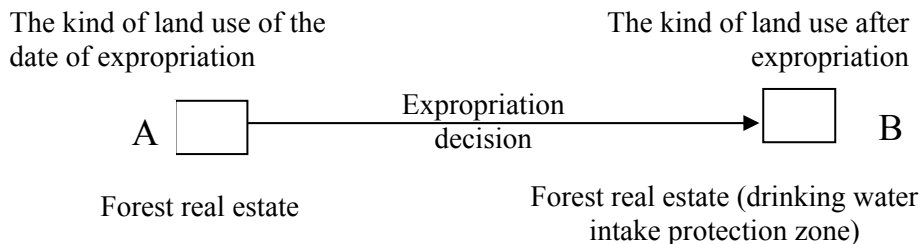
The amount of compensation is determined on the basis of the condition and the value of real estate being expropriated as of the date of signing the expropriation decision. The condition of the real estate is established on the basis of its detailed description. What serves as the basis for calculating compensation is its market value. This does not apply to cases in which the real estate is not subject to market trading due to its functions. In such a case, in order to calculate compensation for

expropriation, the basis is assumed to be the cost-based value of the real estate.

To calculate the market value of a real estate one should consider the following:

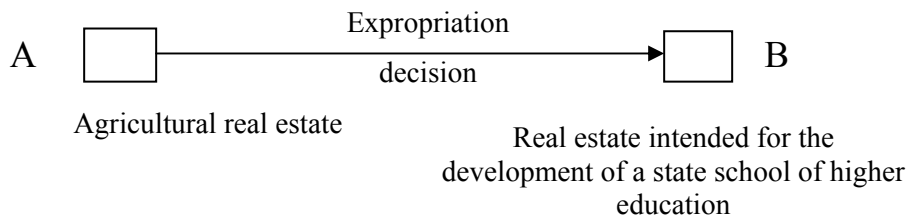
- a) The type of real estate (real estate: land, building, space within a building);
- b) Its location (general, detailed and relative);
- c) The kind of land use (as of the date of signing the expropriation decision);
- d) The degree of technical infrastructure facilities (ranging from no access to infrastructure to being fully furnished with such equipment);
- e) The condition of real estate (stage of development, legal status, technical and functional condition of the real estate itself and its surroundings, including the size, character and degree of urbanisation of the town in which the real estate is situated);
- f) Current market prices of real estates (prices of similar real estates on the local market).

The market value of a real estate is determined according to its current kind of land use – in case the purpose of the real estate is in line with the purpose of expropriation, its value will not rise. This is illustrated by the following example:



Real estate value A > real estate value B
 Compensation = real estate value A (existing use value)

In case the intended purpose of the real estate, in line with the purpose of expropriation, should increase its value, the amount of compensation is to be determined according to the alternative kind of land use adequate to the new purpose.



Real estate value B > real estate value A
 Compensation = real estate value B (development value)

This principle of calculating the amount of compensation is guaranteed by the provision of the article 134.4 of the Real Estate Management Act dated 21 August 1997.

In case the value of a real estate may not be determined due to its type (no transaction of similar real estates, the real estate does not and may not bring profit) – its value should be established on the basis of costs, using the following formulae:

$$V = V_L + V_B$$

Where:

V – cost-based value of the real estate being expropriated (the amount of compensation)

V_L – market value of a land not built over

V_B – cost-based value of all elements comprising the real estate

Land is evaluated using the comparative approach.

Elements comprising a ground are evaluated using the cost-based approach.

To the general principles of calculating compensation for expropriation of real estate, the Real Estate law introduced the following exceptions regarding the method of appraisal:

- 1) forest tree stand;
- 2) areas covered with trees;
- 3) perennial culture plantations;
- 4) Sowings, crops and other annual crops.

In those cases, compensation also covers **lost profit**.

In the case of valuation **forest stands or areas covered with trees**, the amount of compensation depends on whether the forest stand contains **utility material**. If so, the value of wood in the stand should be appraised and added to the value of the land:

$$V = V_L + V_T$$

Where:

V_L – the market value of land

V_T – the value of wood within the stand

In case the stand does not contain utility material or the value of wood which may be acquired is lower than the cost of forestation and cultivation of the tree stand, what should be determined are the costs of forestation (C_A) and the costs of cultivation of the tree stand (C_C) – until the day of expropriation.

$$V_T = C_A + C_C$$

In order to appraise **perennial culture plantations** (e.g. hops, chokeberries), one should determine the costs of starting the plantation (C_S), the cost of its cultivation until first crops are collected (C_C) and the value of lost crops (V_{LC}) between the date of expropriation until the day on which crop yield is fully completed. The value of the plantation is reduced by the

amount of annual depreciation allowances $\sum_{i=a}^T A$ (instalment of amortization), resulting from the period of using the plantation beginning with the first year with crops (a_1) until the day of expropriation (T).

$$V_{PCP} = C_S + C_C + V_{LC} - \sum_{i=a}^T A$$

In order to appraise sowings, crops and other annual crops (V_{AC}), it is the value of expected crops that should be considered (V_{FC}) according to the current market trading, reduced by the value of investments necessary (V_{JC}) to harvest the crops.

$$V_{AC} = V_{FC} - V_{JC}$$

In the period of expropriation proceedings, the owner of the real estate being expropriated may continue to use it for current business activity, which must not be assumed as intended to receive higher compensation.

In case the subject of expropriation is the right of ownership or perpetual usufruct, whereas the real estate is charged with other limited material right, the amount of compensation is reduced by the value of the limited material rights.

Damage compensation, e.g. resulting from building technical infrastructure devices (electricity, gas, water) on the ground should be calculated on the basis of the damage caused. If this causes a decrease in the value of the real estate, the compensation is equal to that decrease.

3 The principle of payment of compensation for expropriated real estates

According to the Real Estate Management Act, compensation for expropriated real estates should be paid out as a lump sum within 14 days of the day on which the decision regarding expropriation and the amount of compensation became final.

Compensation may be placed in the escrow deposit, which is regarded as if the compensation was paid.

The compensation determined in the decision is subject to indexation as of the date of payment. Such a situation may occur in case the compensation is not paid within 14 days. The requirement of indexation does not apply to the compensation correctly placed in the escrow deposit.

Indexation of the compensation is done with the use of real estate price change indicators announced by Chairman of the General Statistics Office in "*Monitor Polski*", the RP official journal. Until the indicators are announced, indexation is done with the use of price indicators of consumer goods and services, announced by this organ in the same official journal.

The principle of payment of the full compensation as a lump sum is a very important and desirable change in the Polish compensation system, in which until as recently as 5 December 1990, as a matter of principle, compensation was paid in instalments. The only possibility of receiving compensation as a lump sum was in the case of agricultural real estates. As

the buying power of the money is falling, this change is one of the important provisions of the constitutional right to legitimate compensation for expropriation.

4 Substitute real estate as a non-pecuniary form of compensation for expropriation

As part of compensation, owners or holders of perpetual usufruct of real estates being expropriated may be offered, and have the right to accept or reject, an adequate **substitute real estate**. Real estates in exchange are granted from the real estate resources that belong to the State Treasury, in case the expropriation is for the benefit of the State Treasury, or from the real estate resources that belong to the relevant unit of local government, in case the expropriation is for the benefit of that unit. Real estates in exchange may be granted with the approval of Chairman of State Treasury's Agency of Agricultural Real Estates, in case the expropriation is for the benefit of the State Treasury.

The difference between the amount of compensation determined in the decision and the value of the substitute real estate is balanced with a supplementary payment in cash. The transfer of the rights to the substitute real estate for the benefit of the person who was granted compensation is done as of the day on which the expropriation decision became final. The decision also serves as the basis for making a record in the Land Register.

The real estate is to be "adequate", which means that it should possess the same features as the expropriated real estate, e.g. area, intended purpose in the spatial development plan, location etc.). Naturally, only an authorised person may propose that another real estate be granted in exchange, and the person has no right to demand it.

The substitute real estate is normally appraised as described in the previous chapter, by a real estate appraiser. This is necessary for purposes such as determining the amount of a supplementary cash payment.

5 Reinstating expropriated real estate vs refunding compensation paid

The expropriated real estate may only be used for the public purpose for which it was expropriated. Should this condition be violated, the previous owner has the right to reclaim the expropriated real estate. The Real Estate Management law also provides other circumstances in which the previous owner may reclaim the real estate.

A principle was adopted that any expropriated real estate may be returned in the condition in which it is on the day of its reinstatement to the previous owner.

There are three possible conditions of the real estate in question:

- 1) **neutral** – the real estate has remained in a similar condition to that on the day of expropriation;
- 2) **impoverished** – the changes introduced to the real estate resulted in a decrease in its value;

- 3) **enriched** – the changes introduced to the real estate resulted in an increase in its value.

The decision to return the expropriated real estate reinstates the right of ownership to its previous owner. The essence and sole purpose of returning the real estate is to abolish the effects of the expropriation decision. The costs of the proceedings related to returning the real estate are incurred by The State Treasury or the local government unit. What is also important in the procedure of returning expropriated real estate is the mutual settlement of dues between the person to which the real estate is being returned and the State Treasury or the local government unit. The amount to be returned by the owner is the compensation granted to him in the expropriation decision – indexed as of the date of returning the real estate, according to the following formulae:

$$A_{CR} = A_{CG} \times c_1 \times c_2 \times \dots \times c_n$$

Where:

A_{CR} – the indexed amount of compensation for the expropriated real estate

A_{CG} – the amount of compensation granted in the expropriation decision

c_n – the indexation coefficient of amounts for i-th year

Until the real estate price change indicators are announced by the Chairman of the General Statistics Office, indexation is declared with the use of price indicators of consumer goods and services, announced by Chairman of the General Statistics Office in “*Monitor Polski*”, the RP official journal.

What should be taken into consideration in the ultimate settlement of accounts between the parties is the condition of the real estate as well as the return of the real estate previously offered in exchange, if any, provided it was offered as part of compensation.

A condition was adopted that cash compensation returnable following their indexation must not be higher than the market value of the real estate (V_m) on the return date:

$$A_{CR} \leq V_m$$

or in the case the market value may not be determined:

$$A_{CR} \leq V_C$$

where:

V_C – the cost-based value of the real estate

In case the value of the expropriated real estate has increased or decreased ($\pm \Delta V$) as a result of the activities conducted directly on the real estate following its expropriation, the compensation (A_{CR}) is reduced or raised by the amount equal to the difference of the value as of the return day:

$$A_{CO} = A_{CR} \pm \Delta V$$

where:

A_{CO} – the ultimate amount to be returned by the owner of the real estate

$$\Delta V = V_{TR} - V_{TD}$$

where:

V_{TR} – the value of real estate as of the return date

V_{TD} – the value of real estate as of the date of the expropriation decision.

In order to value the real estate one should consider the condition of the real estate as of the date of expropriation and as of the date of its returning. What is not considered are the effects of the changes on:

- 1) its intended purpose in the spatial plan;
- 2) its surroundings.

6 The assessment of the current status and proposed changes

The duty to pay compensation for expropriated real estate stipulated in the Real Estate Management law applies to the duty to remedy damages within the limits of the losses incurred by the expropriated person. This compensation equals the market value, or, in special situations, the cost-based value of the right to the real estate to the reduction of the value of that right due to its limitation. The compensation duty does not apply to the profit the real estate owner could make if the real estate had not been expropriated.

It does not include, for instance, anticipated profit which was lost due to the liquidation of a craftsman's workshop located in the expropriated building, a lapse in running a business activity, additional costs of advertising that may necessary to prevent the loss of customers in case of deteriorated access to a hotel or restaurant, etc.

The only exceptions to this principle are related to compensation for sowings, crops and other annual crops as well as perennial plantations.

The procedures of calculating compensation take into account the value of yield that would have been gathered if the real estate had been used continually.

What also raises doubt is the solution in the Real Estate Management law regarding indexation of compensation in cases when compensation has not been paid in time. This is because the new amount payable following the indexation is, in fact, a change of the decision regarding the amount of compensation determined by a real estate valuer.

In practice, compensation is often paid with a significant delay.

In decisions regarding indexation of a fixed compensation, a general principle should be observed of determining legitimate compensation. In the event that between the times that compensation is determined and its indexed amount is finally paid, the market value of the real estate may change (increase) considerably.

The change in the value of the real estate is in many cases higher than the change in the buying power of the money. In such a situation, it would be reasonable to conduct another valuation of the real estate on the date of payment of the compensation.

What is also questionable is the provision in the law regarding offering real estates in exchange for the expropriated real estate. The wording “may be granted” indicates that the actual choice of the form of compensation is limited.

The reservation in the Real Estate Management law that the substitute real estate must be “adequate” should only be interpreted to mean that the duty to grant such a real estate is valid in case the new real estate has similar characteristics to that being expropriated with relation to its location and purpose designated in the local spatial development plan, as well as the degree of development with elements of technical infrastructure. It seems that the decisive factor in the assessment of whether or not a given real estate is “adequate” as understood by this provision should be the position of the owner of the expropriated real estate.

7 Conclusions

In Poland, the right of ownership is guaranteed by the Constitution. This right, however, may (understandably) be expropriated or limited, in case a public purpose so requires. In such a case, compensation is paid in return for the lost real estate.

The question is whether the compensation for expropriation of real estate is legitimate.

The study of the principles of calculating compensation according to Polish law leads to the conclusion that there is a fair amount of good will to compensate owners of expropriated real estate for the loss that they incur.

Nevertheless, the law is not perfect. In many cases, persons being expropriated feel aggrieved by the very fact of the expropriation itself as well as by the amount of compensation offered to them. This is particularly true in the case of elderly persons, who tend to feel greater resentment caused by the loss of their real estate. More often than not, they cannot accept new conditions in which to live or resume their professional activity, particularly in case it was not only land that was expropriated, but also buildings. The compensation equal to the market or cost-based value of their built over real estate in some cases proves too low to buy a new real estate. This is the case when the local market offers no similar real estates for sale, and the cost of purchase of a plot of land and raising a new building is higher than the compensation received.

The procedures of calculating the amount of compensation do not take into account what is called “moral” losses.

For all these reasons, there is an urgent need to discuss ways to improve the provisions of the law and the methods of real estate appraisal for the purpose of this important document, used by the State Treasury or local governments to manage real estates and to economically develop their

respective parts of the country. Due to the interference of the state and local governments into the general principle of protecting the right of ownership, the problem of compensation for real estate expropriation touches not only the economic, but also the psychological sphere.

Because of the many doubts as to the compliance with the Constitution of the Republic of Poland if the amount of compensation for real estate expropriation is just it can be expected that the problem will be discussed by Polish Parliament. Experiences of other countries should be taken into account in debate of this problem (e.g. Baum A. and G. Sams, 1990; Hayward R.E.H, W.H. Rees, 2000).

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ⁱ Common law is the system of law in England which originated from common usage and from judicial decisions, not from statutory legislation.

ⁱⁱ Although normally it is public corporate bodies, such as local authorities (municipalities), which are given compulsory purchase powers, sometimes private organisations, such as oil companies, will seek these powers.

ⁱⁱⁱ Each local planning authority (LPA) is required to have both a planning policy statement and a development plan, which indicate how land is and should be used and also the predicted needs of the municipality. Where potential development for a primary use (i.e. residential, commercial or industrial) is indicated on the development plan, it can normally be anticipated that any planning application for such a primary use, the details of which reflect the policy of the LPA, will be approved. However, this is not always the case, and the LPA is reactive to planning applications, not proactive in securing the development it considers necessary. So,

unless the local authority acquires land, the LPA has no power to require land to be developed in accordance with its plan.

^{iv} defined as: a freehold or leasehold interest with at least three years left to run, in a dwelling, an agricultural unit or in any other property where the rateable (taxable) value does not exceed a specified amount (£24,600, as at 2005, which represents a net annual rental value). In the UK, all land is owned by the Crown. People can only own an “interest” in land. The interest in land which gives the most rights is the freehold interest – effectively perpetual ownership with all the rights permitted within the law, including development. The next most valuable is a leasehold interest, which is a contractual right to occupy, sublet etc., subject both to the law and to the terms agreed with the (freehold) landlord. Other lesser rights over land, such as easements e.g. the right of access, exist which are subject to greater limitations.

^v This payment replaces the Farm Loss Payment with effect from 2004.