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## **Betterment deduction as a form of compensation**

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**Abstract:** *The main aim of this paper is to examine the compensation-betterment issue in the process of granting compensation for compulsory acquisition of land. This situation is the opposite of the decline in the value of a retained land (injurious affection and severance). The paper focuses on the concept of betterment off-set for the amount of compensation with the analysis from the Polish point of view. In the first part of the paper a definition of the term “betterment off-setting” is presented and evaluated. Then three approaches to betterment are discussed: betterment set off rule as a general rule, a betterment deduction rule limited only to compensation for injurious affection and severance and the lack of betterment provisions. The paper briefly evaluates each of these approaches. Further the Polish approach to betterment in the context of compensation provisions is discussed.*

*On the basis of such examination the paper presents the fairest method of recapturing the enhanced value of land. In this optimal method recapturing provisions should be separated from the expropriation provisions. Moreover the development agreement supported by development contribution seems to serve as the main tool of recapturing. The method discussed resolves also the problem of a public project (ex. subway) increasing the value of not only the land adjacent to the acquired land but also of the further parcels. I suggest that deduction of compensation equal to the amount of infrastructure levy should be allowed only when a landowner demands it.*

*Finally the paper suggests that only betterment charges can successfully deal with the increase in the value of private property accrued by public project.*

**Keywords:** *just compensation, betterment deduction, givings, betterment charges.*

## 1 Introduction

*Use of land rents, or, at least, of a major fraction of it for public purpose is therefore not merely an ethical imperative derived from categorization of these rents as an unearned income; derived from private appropriation of publicly created value; but is, even importantly, a fundamental requirement for economic efficiency*

(W. Vickrey - City as a Firm)

This paper is based on a general idea that taking creates value to a certain group of the owners of the surrounding properties (givings). Givings and takings can be seen as two sides of the same coin. The question is how to link these two opposite instances of a public authority action when giving and taking occur to the same owner.

In this paper I attempt at examining only one aspect of the relation between givings and takings - mainly a situation when only a part of the property is compulsory acquired (partial taking), as a result of which the owner of the remaining land receives benefits. In most cases partial taking increases the value of the remainder of land that belongs to the same owner. It needs to be pointed out; however, that partial expropriation may also affect the remainder of land negatively in the form of severance or injurious affection. Nevertheless in this article I attempt at investigating only the positive effects of compulsory acquisition in order to determine if betterment offset can be used as an element of the taking law.

This article examines the deduction of compensation especially from the Polish perspective. The analysis of betterment recapturing in the context of compensation granting from this perspective proves particularly interesting due to a great number of infrastructure projects such as highways, trunk roads and sport facilities that are being undertaken in Poland before the European Championships in football in 2012.

It should be pointed out that in most legal systems the construction of roads and railway can be compared to a military polygon on which expropriation regulations are being tested. Poland seems not to be an exception.

What is particularly interesting, for 90 years the Polish land use law has been anti-betterment-oriented. In 1919 the first expropriation act contained a provision directly prohibiting deduction from compensation any increase in value of the retained land caused by expropriation. Since that time situation has not changed significantly. As a result of such legal approach partial expropriation is currently not regulated in Poland. Furthermore the recapturing issue has never been discussed by legal scholars or planners in Poland. This paper attempts at initiating such discussion that eventually will lead to the foundation of givings provisions in the Polish land use law. Due to the lack of literature on the matter I will refer in my paper mainly to the American and British theories on betterment recapture and their practical

applications. Finally I will propose an adoption of some of these legal tools in Poland.

## 2 The concept of “betterment offset”

Generally speaking the term “betterment” refers to benefits which an owner receives due to public activities on an adjacent parcel that has been expropriated from him.

Firstly, for better understanding of the term “offsetting betterment” the concept of betterment recapture needs to be discussed. The betterment recapture philosophy is based on the idea of Henry George. His book *Progress and Poverty (1879)* may be described as the bible of recapturing. He states that all public services should be financed by a single tax on land value. More recently George’s Theorem has been taken up by the Nobel Prize winner William Vickrey.

With this economic background the definitions related to betterment recapture deserve a word of explanation. The term ‘*betterment*’ was best described by the Expert Committee on Compensation and Betterment (Uthwatt) during works on reforming of British planning system in 1942 as: *any increase in the value of land (including the buildings thereon) arising from central or local government action, whether positive, e.g. by the execution of public works or improvements, or negative, e.g., by the imposition of restrictions on other land.* This definition is still the most popular and the best known definition of “betterment” in the British literature. In the UK Uthwatt idea led to several attempts at introducing a betterment levy. All proved unsuccessful. However, now Planning Gain Supplement (GPS) is being discussed and will eventually replace planning obligation as a remedy for ineffective planning.

Miszczynski and Hogman in their famous book “Windfall for Wipeouts” (1979) popularized the term “**windfall**” that defined betterment as: “**any increase in the value or real estate – other than caused by the owner - or by general inflation**”.

These authors examined different techniques of recapturing windfall but did not investigate the problem of recapturing windfall arising from partial taking. But the article that seems to even more important for examining betterment deduction is the one entitled “Givings” written by Bell and Parchomovsky. These authors initiated the discussion of the structure of givings law. They distinguished three forms of taking and giving – physical, regulatory and derivative. The most relevant for betterment deduction is the derivative giving which is defined as “*a result of a government giving or taking, surrounding property increases in value even though no direct giving has occurred*”. The relation between physical taking and derivative giving discussed by Parchomovsky and Fordham is the core element of the examination in this paper.

While working on the Compulsory Purchase and Compensation Bill in the UK The Law Commissions as well as other participants of this legislation proceeding proposed a new definition of betterment in the new compensation law. According to this proposal betterment is defined as **“any increase in the market value of the retained land attributable to the nature of, or the carrying out of, the relevant project”**.

The definition provided raises the question concerning the meaning of such terms as “retained land” or “relevant project”. In order to avoid any terminological confusion it needs to be clarified that betterment is an increase in the market value or, in other words, an enhancement in the economic value of a property.

Another term that has to be defined is that of “offsetting betterment” (betterment deduction). The concept is based on the presumption that there is a retained part of land and the value of retained land after taking is relevant for the amount of compensation.

The cradle of a betterment deduction is the US, where in the XIX century benefit - *offset principle* was first used. Under this principle compensation could be reduced by special benefits to the remainder property arising from the implementation of a scheme of public works. This tool was applied for acquisition of farmlands for railroads and compensation was deducted by the value of benefits. The major disadvantage of this method, however, was its unfairness since the offset rule was applied only to the owners the property was taken from. Consequently, their neighbors whose properties were not taken could receive pure benefits free off any contribution. In the United States this principle developed to the average reciprocity of advantage rule in regulatory taking cases.

Yet another term that calls for consideration is the term “benefit” and more importantly the elements that can be included in its scope. Generally speaking benefits are the components of the value of a parcel or a real estate that arise from a governmental action. Thus the application of the evaluation “before and after” method is possible where the sales figures in affected area show if the project has enhanced the value of properties (Kollins, Eaton 1992). What remains to be determined, however, is whether every change in the value of land after carrying out a public project is a result of that project. Sometimes the value of property is affected by other factors. Therefore, whenever benefit offset principle is used, especially in the US, general benefits have to be distinguished from the special ones.

The former are the benefits that come from the community in general. These affect beneficially the value of properties that have not been taken or damaged in any way or have not been affected by the taking in a direct way (Kollins, Eaton, 1992). The latter are to be taken into consideration in condemnation cases. A special benefit is a benefit that directly results from a benefit to the residue. And even though more than one property is

beneficially affected by a public project the benefit can still be classified as special (Eaton, 1992). Eaton defines special benefits as those that arise because of the particular relationship between the remainder parcel and the public improvement. And it is precisely this unique relationship that serves as the core aspect of the special benefits. It is very difficult, however, to distinguish this element of the value of land from other factors.

Since special benefits resulting from the public project are quite difficult to define the most important factor that constitutes betterment has to be an increase in the value of land caused by adjoining (of the adjacent parcel) to the land where public project has been carried out. As a result such betterment concerns only the adjacent land. Obviously it is necessary to define in appraisal standards maximum distance from the land on which the project is carried out as specially benefited ex. 100 m from stadium, 100 meters from the boarder of a public road.

### **3 The enhancement of retained land as a form of just compensation**

In this part of the paper the consistency of the betterment deduction rule with the constitutional just compensation rule will be examined. Such examination must begin with the statement that just compensation is not synonymous with cash payment, so non-monetary forms of compensation are also acceptable. Otherwise there is no place for betterment deduction among expropriation provisions in any democratic country.

In Poland the just compensation rule set out in article 21, section 2 of the Polish Constitution guarantees that private property shall not be taken without just compensation. The Constitution does not use the term “full compensation”, contrary to the Hungarian Constitution as well as the Finish and Norwegian legislation where the term “full compensation” is used. Nevertheless the core issue in this examination should concern the legality of deduction of payment due to the increase in the value of retained land as a form of compensation.

Over the last fifteen years, the Constitutional Court has emphasized many times that just compensation should be equivalent to the value of the property taken. In other words, the amount of compensation should enable the owners to restore themselves to the position before the taking. However, the Court has clarified neither the standard of just compensation nor the allowance of non-monetary compensation. The Court holds that just compensation is compensation related to the value of the taken property. The Court found it significant that the constitutional legislator did not employ the term “full compensation,” but instead used the adjective “just,” thereby giving this provision a more flexible nature for expropriation agency. Accordingly, it should be assumed that particular situations may occur where other important constitutional values justify the conclusion that compensation is “just” even when not amounting to “full” compensation. Such statement justifies the opinion that betterment is a form

of just compensation. And in my opinion betterment can be qualified as a form of just compensation. Moreover ignoring the enhancement of the retained land in a process of granting compensation creates unfairness. The owner whose property has been taken receives only monetary compensation whereas the other from whom only a part of property has been taken can receive both the monetary compensation and the increase in the value of retained land. In granting just compensation also the social aspects of the property rights have to be taken into consideration. There is no reason to exclude unearned benefits from the scope of just compensation. Quite on the contrary the benefits should be taken into consideration in such cases and their value needs to be allowed in determining the amount of compensation. On the other hand, the right to compensation for the taking of property includes compensation for any decrease in the value of the retained property. The decrease in value is determined by the land's market value. And within this framework the increase in the value by the amount of benefits to the remaining property is a form of compensation. Therefore compensation can be perceived as a form of a value game.

Unfortunately, the Constitutional Court in its judgment on May 8th, 1990 declared section 10 of the 1985 Land Management and Expropriation Act unconstitutional which regulated compulsory dedication of land without compensation. Consequently, since 1990 the compulsory dedication of land which is the most popular form of exaction in many democratic countries has been prohibited in Poland. In its judgment the Constitutional Court showed indirectly its anti-betterment approach declaring that only monetary compensation is constitutional.

It must be pointed out that The European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) with Protocol No. 1 to the ECHR is an important instrument for the protection of private property. The ECHR's main instrument to protect private property is article 1 of the First Protocol, which limits the ability of public authorities to interfere with private property rights.

However, only one judgment of the European Court of Human Rights refers to the matter related to offsetting betterment in a process of granting just compensation. In the *Serghiedes vs Cyprus* the Court ignored the opinion of the Cypriot government that the increase in the value of the retained part of a parcel taken for widening of the street is a form of just compensation. It is therefore unclear what the ECHR's stand on betterment offset is.

To summarize this part – there is no logical argument against treating betterment as a form of just compensation. Yet the problem of equity rule still remains. Since betterment offset applies only to the owners of partly taken land it introduces the element of inequality and discrimination of these owners because the others whose land has not been expropriated receive gain and do not pay any contribution.

#### **4 Legal approach to betterment deduction**

In this part of the paper three theoretical approaches to offsetting betterment from compensation are distinguished and each of them is briefly presented and evaluated.

##### ***4.1 Betterment offset rule as a general rule***

According to this rule whenever a property is subject to a partial physical taking compensation shall be reduced by the value of any increase in the value caused by carrying out the project that caused the expropriation of this property.

In the process of calculating compensation the increase in the value of the retained land is taken into consideration. The calculated amount is then deducted from compensation for the expropriated land as well as for severance and injurious affection. Consequently, the enhancement of the retained land may fully offset the value of the taken land. The value of the payment received by the owner added to the value of the remaining property after the taking, and enhanced by the special benefits, is equivalent to the value of the owner's property prior to the taking.

As has been pointed out in the first part of the paper the key factor necessary for the wide application of the offsetting rule is a clear appraisal rule for distinguishing between special benefits and general benefits. The examples of this approach can be found in the following American States: Arkansas, Colorado, Illinois, Minnesota, New Hampshire, South Carolina and Wisconsin.

In the UK a wide betterment offset provision is contained in article 261 of the Highways Act 1980 when assessing the compensation payable in respect of the compulsory acquisition of land by a highway authority. This example shows that betterment is often used under the regulations of expropriation of land for highway expansion. The construction of highways seems to be the legal field in which betterment offset is more acceptable than anywhere else. As a result of such situation there is no betterment regulation in the general taking law. Such regulation is applied, however, for highways schemes. There is no reason to treat the highway acquisition separately from other types of acquisition. Of course construction of highways with special access to it may increase the value of contiguous land significantly, but the legal practice can be constitutional or not irrespective of its specific aim. The aim of acquisition, for instance, cannot legitimize any practice in the land use law. Also in Sweden general benefits are deducted from compensation.

The general offset rule is sometimes limited by increasing the maximum percentage of deduction ex. up by 50 % of the betterment could be offset. Colorado (the US) is an example of a state where the general offset rule has been applied but only in a limited way. Special benefits may be used to offset damages and/or the value of the part of the property taken

but may not exceed 50% of the value of the part of the property taken. One form of this deduction is also a compulsory dedication of land in the case of land subdivision.

It remains to be determined whether the compulsory dedication of land under planning procedures as taking up to ex. 25 percent of plot without compensation in the process of land subdivision is a form of a betterment recapture or not.

#### ***4.2 Betterment deduction rule limited only to compensation for injurious affection and severance.***

This technique of recapturing enhancement is more popular and less controversial than the previous one. When an owner claims compensation for the decrease in value of the retained land obviously the value of the retained land has to be estimated. The values of this part of the property before and after the taking need to be compared. But the main drawback of this approach is the use of the increments to the retained land only against compensation for severance and injurious affection, but not to offset compensation for the property taken.

In the UK section 7 of 1961 Land Planning Act allows to offset the increase in the value of the other land only from the compensation for injurious affection and severance. This regulation has been examined in a landmark case *Wilson vs Liverpool Corp* (1971). And as can be easily observed this rule is deeply rooted in the British planning law. Also in Australia section 23 (1)(c) of the Commonwealth Act includes the enhancement or depreciation in value of the interest of the claimant, on the date of acquisition, in other land adjoining or severed from the acquired land by reason of the carrying out of or the proposal to carry out the public purpose for which the land was acquired. Recently with the introduction of the new Compensation Code in the UK some changes to the rule discussed above were proposed. These did not intend to widen the rule for compensation other than the amount of severance or injurious affection, or deduct the amount of any betterment (the total shall not be less than nil) and concerned only introduction of very strict definition of betterment offset and “adjacent or contiguous land”.

In this form the appraisal technique is based on estimating the difference in the value of the whole land before taking and the value of the retained land taking into consideration any effect the relevant project may have on that value.

This method, in fact, leads to marginalizing the betterment problem since it ignores the enhancement of the retained land in calculating compensation for psychically taken land.

#### ***4.3 Prohibition of offsetting***

This approach ignores the increase in the value of the retained land in a process of granting compensation. Two forms of this approach can be



distinguished, the first - when legal system contains direct provisions prohibiting deduction of any increments from the amount of compensation and the second “hidden prohibition” due to the lack of any provisions which could replace monetary compensation with other alternative.

In the US currently two states Iowa and Mississippi prohibit offset benefits either compensation for the property taken or severance damages to the remainder. According to Miss. Code Ann. § 11-27-21 in determining damages, if any, to the remainder if less than the whole of a defendant's interest in property is taken, nothing shall be deducted there from on account of the supposed benefits incident to the public use for which the petitioner seeks to acquire the property.

## **5 Betterment deduction in Poland**

From the Polish point of view it is very difficult to discuss this matter due to the lack of any provisions concerning appraisal of retained land. Moreover there is no published court decision referring to the problem of the betterment of the retained land. It may be said that Polish legal system permanently ignores betterment issue.

Poland before World War II may be presented as an example of a state where betterment was directly prohibited. As it was mentioned above the law prohibiting betterment offsetting was passed in Poland in 1934. According to article 27 section 2 of the Expropriation Act from 1934 “any increase in the value of real estate caused by carrying out the project e.g. constructions or installation for that requires prior expropriation is not included when estimating the compensation”. On the other hand any decrease in the value of the retained land was compensable (article 27 sect. 3 Expropriation Act 1934). Currently in Poland there are no provisions that allow for the reduction of compensation below the fair market value. The lack of such provisions can be interpreted as a right to receive a monetary compensation. However the fair market value means – only the value of the taken land without compensation for other land. In this approach it is not necessary to eliminate any elements of the value of retained land in assessing compensation. I refer to such situation as “**hidden prohibition**”. Such prohibition of offsetting betterment from the reminder in my opinion distorts just compensation on one hand and leads toward absolutizing of the property right on the other.

Currently in Poland under the provisions of Land Management Act 1997 (Polish *ustawa o gospodarce nieruchomościami*) the compensation equal to the market value of the taken land is granted for an ex- owner of expropriated land and the appraiser cannot take into account the value of the retained land. Only the value of easements can be deducted from the amount of compensation (section 128 subsection 2 Land Management Act). Article 151 of the LMA 1997 defines market value as the expected price achievable on the market, when the parties of the transaction were not related, and were

not acting under pressure. This valuation is based on examining recent sales prices for other properties in the area deemed to be comparable to the property in question. The level of compensation to be provided for expropriated land is established by the date on which a property is transferred to public agency. The compensation mechanism excludes all consequential damages associated with the taking, such as the loss of future profits.

The detailed compensation rules are contained in the Cabinet's Ordinance of 21 September 2004 on the Detailed Rules and Procedure for Preparation of the Valuation Report where valuation mechanisms have a significant impact on the amount of compensation. The compensation is payable only for the depreciation in the value of land and does not include any decline in the value of buildings, lost profits, and other possible inconveniences.

What needs to be pointed out, however, is that subdivision of property is always connected with partial expropriation and in most cases the value of land increases as a result of subdivision. For instance, when the value of a parcel of a total surface of 5000 m<sup>2</sup> is equal to 100 € per square meter, after taking of 2000 m<sup>2</sup> for public use, the retained land amounts to 3000 m<sup>2</sup> and then the value of 1 square meter is equal to 110 €. So totally the enhancement as a result of subdivision is 3000 €. This factor cannot be ignored in the process of appraising. To illustrate such cases one Polish example should be presented. While constructing the “*Siekierkowska Route*” (*Trasa Siekierkowska*) in Warsaw a considerable amount of land was expropriated. Market prices in this part of Warsaw were about 90-130 € per square meter and the local government of Warsaw acquired the first few plots for much higher prices, 200 or 250 € in order to avoid the long-lasting expropriation procedure. Then the further plots were evaluated by the fair market value of the property taken. The appraisers examined the recent sales prices for other properties acquired for the construction of public project in the area that should be comparable to the property in question. I called this very strange situation “expropriation effect”. It is very problematic to decide whether to include this increase to the scope of betterment or not.

## **6 Betterment charges and compensation**

When we think about improving betterment we need to construct a comprehensive model of betterment recapture. Betterment deduction can only exist as an integral part of such system playing a marginal role in it. If any legal system restricts the betterment issue only to benefits offset will eventually fail to prove effective. Especially when betterment offset is linked only to the physical taking. The benefit offset deduction from compensation when other benefiting owners do not pay any contribution serves as a very convenient target of attack from the opponents of recapturing. The main condition of effectiveness of such mechanism is

creating by a public agency a general instrument for recovery of increments caused by public projects.

As the alternative the introduction of betterment charges which should be a form of public levies (taxes) collected after completing of a public project should be considered. These charges would be introduced in virtue of local statutes adopted before launching the new project. In such statutes the boundaries of the increment zone should be described. Charges would be collected after completing the project since in practice the real increase in value of land can be evaluated only after carrying out the project. The special fund and account should be established for collecting of charges and paying compensation. The total amount of charges could not exceed a percentage of expenditure on the project described in act (ex. 75 percent). The assessment of the enhancement should be made after the project's completion because the appraiser has to use sales evidence after operating of the public project ex. road. The methods of assessment of charges could be chosen by the public agency in a statute ex. fixed uniform rate based on frontage or area within 50 m distance from a new road.

Moreover after the adoption of betterment charges statutes yet before completing the project it should be possible to prepay a charge based on the provisional evaluation made by the public agency. Before the completion of the project an owner should be able to negotiate a development agreement that would exempt him from paying charge. The big advantage of the prepayment should be instalments with the low rate and deduction of the first instalment from a base for the income tax.

The issue that remains to be settled is how betterment charges link with compensation for expropriation. In the model discussed these two elements are connected by a common fund and the owner who can deduct the amount fund and the owner who can deduct the amount of compensation (part or whole) from a betterment charge by virtue of development agreement or prepayment instead of monetary payment. And it must be emphasized that deduction for betterment could only be made on the owner's request and only if the betterment ordinances were previously introduced by the governmental agency.

## **7 Conclusions**

This paper tries to prove that betterment of retained land is a form of just compensation, but the limitation of betterment issue only to deduction of monetary compensation and to taking law in an anachronism. The model of betterment charges proposed in the previous part gives an opportunity for introducing an effective tool for windfall recapturing. And this instrument can be linked with compensation procedure.

An introduction of recapturing betterment is a fairness issue which comes from the idea that the property entails obligations. Therefore, no legal system can ignore the social context of the property rights. Moreover

the enhancement of private property that arises from a public action requires public reaction. The public action is obviously an activity which significantly increases the value of some properties. The value of others may be increased to a smaller degree with some properties losing their value. That is why the redistribution is necessary.

From the perspective of Polish legal system the primary legal challenge is to begin regulating the retained land issue as well betterment issue as injurious affection and severance. Linking of adjacent levies and betterment levy regulated in Polish planning law with compensation for the taken land is a second challenge. The practice of impact fees and a special assessment could be imported to Poland from the US and will replace impractical adjacency levies.

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