

## **Compulsory Purchase Compensation in Polish Law on a Background of Solutions Adopted in Other Countries**

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**Key Words:** property, expropriation, compensation, Poland.

### **SUMMARY**

The basic conditions of compulsory purchase as regulated in many countries by constitutions or other acts of fundamental character are:

- public purpose investment realisation
- just compensation payment

This paper therefore, shall discuss the principles in relation to the determination of monetary fulfillment for deprivation or limitation of property rights and in so doing, attempt to provide answers to the following:

1. How to interpret the meaning of just compensation on the basis of Polish law
2. How the principles set out in the constitution are implemented by detailed regulations
3. How the value of compensation is determined
4. What are the general principles of compensation determination in other countries

As a consequence, not only was an analysis made of Polish law and its regulations but also empirical research was conducted on a particular area (the province of Warmia and Mazury) where public road construction investments were carried out. Additionally, the authors have produced a compulsory purchase questionnaire that was sent to many countries.

The results of empirical research and analysis of given answers led to specific conclusions:

1. Polish regulations pertaining to compulsory purchase compensation determination do not fulfill the “just compensation principle”
2. There are no integrated rules of compensation determination on the international arena
3. The most appropriate forum for forming the above mentioned international regulations would appear to be FIG and FAO

# Compulsory Purchase Compensation in Polish Law on a Background of Solutions Adopted in Other Countries

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## 1. INTRODUCTION

### THE INTERPRETATION OF JUST COMPENSATION IN POLISH LAW

The starting point for consideration of the amount of compensation and the rules concerning its determination ought to be the 21<sup>st</sup> article of the Polish Constitution which allows exceptions in general ownership protection principles: “expropriation is acceptable only for public purposes and for **just compensation**” (Polish Constitution). The last two words of the

Fig. 1 Interpretation of just compensation



Author's own study

cited article and their interpretation were, “the guidelines for detailed regulations”, which includes the principles of compensation’s determination (Szalewska 2005).

The principle of just compensation and its interpretation has been the subject of jurisdiction on many occasions before the Polish constitution tribunal. This notion used to be identified with equivalent compensation because “only in that way does it not violate the core idea of compensation for taken rights” (Constitutional Tribunal K1/90). The Constitutional Tribunal claimed that equivalent compensation gives the owner the possibility of recreation of a taken good or in other words, equalizes its ownership economically (Constitutional Tribunal K1/90). Just compensation is compensation that “does not harm nationals” (Constitution Tribunal K2/90). It does not mean, however, it has to compensate every kind of property loss (Constitution Tribunal K20/02).

All of the above quoted elements of just compensation interpretation lead to the conclusion that its’ upper limit should be drawn by the amount of full compensation, whereas the lower limit is drawn by the value that equalizes the so called economic ownership – the market value of the expropriated property (Fig. 1). The breadth of the range (nature and amount of compensated elements that influence the owner’s economic situation) should be dependent on the scope and the kind of ownership right to interference.

## 2. IDENTIFICATION OF EXPROPRIATION CONSEQUENCES THAT MIGHT INFLUENCE THE PROPERTY OWNER'S ECONOMIC SITUATION

The detailing of elements that might influence the economic situation of a property owner requires a particular ownership right interference arrangement beforehand. The property use, both in the date of expropriation and its' probable use had expropriation never taken place, were also essential. The scope of interference therefore, substantially determines the strength and number of relevant elements.

According to the results of research carried out by the authors of the following paper that dealt with property expropriation for public road construction in the Warmia and Mazury Province (northern part of Poland), the whole process can basically proceed in two negative scenarios (positive scenarios have been omitted):

- Scenario 1 in which property right interference enables previous use of property. (Fig. 2)

*Fig.2. Visualisation of a partial property expropriation example for widening a road - Scenario 1*



*Author's own study*

- Scenario 2 in which property right interference disables previous use of property. (Fig. 3)

Fig. 3. Visualisation of entire property expropriation for building a new road - Scenario II



Author's own study

The adoption of model scenarios enabled identification of elements that might influence the economic situation of expropriated property owners. For this purpose the following research methods were used:

- Primary source analysis (access to documents provided by the Road Authority (Generalna Dyrekcja Dróg Krajowych i Autostrad), documents that in particular dealt with expropriated property owners' objections concerning the amount of compensation and documents confirming the legality of their claims)
- Deduction

In the first scenario, regardless of the use of properties, the objection that was formed quite often was the fact that **the decrease in the value of the remaining property was not taken into consideration** during compensation determination. There were many reasons for the above decrease. In some cases the residential property owners complained about the noise being greater after realization of the investment, which had a negative influence on the comfort of living and clearly decreased the value of the property. A similar effect on property value was noted following an increase in vibrations coming from public roads, especially after investments concerning modernisations.

The objection that dominated in the case of commercial properties was that owners were **not compensated for lost profits** that they suffered because of expropriation. The loss of profits was both temporary (especially during the building process) and permanent (caused for example by the reorganization of traffic and the loss of considerable numbers of clients).

The objection concerning **additional costs** that the owners had to cover was formed in particular by farmers (reorganization of traffic in many cases lengthened the distance to cultivated plots, directly increasing transport costs - the same situation took place when the shape of the plot was changed). (Fig. 4)

Fig. 4. The elements of just compensation – Scenario I



Author's own study

In the second scenario when the whole property had to be taken because of the fact that the remaining property could no longer be used, giving the owner the possibility of recreation of a taken good became very important.

The process of reconstruction of taken property requires finding an alternative asset, one that could replace the subject of expropriation. Such a search may not only be very **time consuming** but also **expensive** in the case of using the help of a real estate agent. Recreation of taken property involves **additional costs** connected with new property acquisition – for example, notarial fees or land register changes. In terms of commercial property, relocation of the business results in a temporary **loss of profits**.

Fig. 5. The elements of just compensation – Scenario II



Author's own study

The listed elements that could influence the economic situation of the property owner have been used in the following part of the paper in order to verify if the Polish law, detailed above, realises the just compensation principle. What one needs to add in this context is that the presented list is not exhaustive. For the purposes of this paper the identification of elements was limited to those that empirical research has revealed most often.

### 3. REALISATION OF THE JUST COMPENSATION PRINCIPLE IN DETAILED LAW.

Polish legislation in respect to compulsory purchase compensation determination is as follows:

- The Real Estate Management Act, dated 21 August 1997
- The Detailed Principles of Preparing and Executing Public Road Construction Investment Projects Act, dated 10 April 2003
- Council of Ministers regulation: Real Estate Valuation and Preparation of Appraisal Reports, dated 21 September 2004

The similarities and differences in expropriation procedures and the means of compensation determination regulated by The Real Estate Management Act and The Detailed Principles of Preparing and Executing Public Road Construction Investment Projects Act are presented in Chart 1.

Chart 1: Compulsory purchase compensation according to The Real Estate Management Act and the Detailed Principles of Preparing and Executing Public Road Construction Investment Projects Act  
Source: Żróbek, Walacik, 2008

	The Real Estate Management Act	The Detailed Principles of Preparing and Executing Public Road Construction Investment Projects Act	
<b>compensation determination</b>	Expropriation decision	Compensation decision	
<b>COMPENSATION</b>	<b>Date of property definition</b>	Date of the decision for road investment approval	
	<b>Date of property value assessment</b>	Date of decision for expropriation	
	<b>Basis of compensation determination</b>	Market value (in special situations, cost value). Exceptions concerning forest stands, areas covered with trees, perennial plantations, annual crops.	
	<b>Compensation payment</b>	Once, within 14 days of execution of decision for expropriation	Once, within 14 days of decision for compensation is made final
		If compensation is not paid within 14 days it must be subject to indexation as of payment date	
If the owner of the property refuses to take compensation, the aforementioned compensation is placed in the escrow deposit, which is deemed to be equivalent to said compensation			
<b>Authorities responsible for compensation payment</b>	County Council Chairman/Province Governor		

The amount of compensation is set by the County Council Chairman in an expropriation decision (or Province Governor in a compensation decision in respect to properties taken for public road building investment). For the purposes of such, certified valuers are employed to make a valuation.

The basis of compensation is the market value of the property. This does not apply, however, in a situation when a property, because of its nature or function, is not sold on the market. If so, the basis of compensation is cost-value assessed in a cost approach.

The most important aspects the valuer has to consider while estimating the market value of the property are presented in Fig 6.

The market value of the property is estimated according to current property use in case its value after expropriation does not rise. If it does, after expropriation, the market value is estimated according to land use qualification.

#### 4. EXCEPTIONS TO GENERAL RULES OF COMPENSATION DETERMINATION

Not all the general rules presented above always apply. Polish law provides exceptions to such as set out in The Real Estate Management Act. The first group is connected with the market value estimation of:

- forest stands,
- areas covered with trees,
- perennial plantations,
- annual crops.

In the above case, the amount of compensation includes also lost profits (Żróbek R. & Żróbek S. 2007).

Compensation for losses resulting from, for example, building technical infrastructure (electricity, gas, water) on a property is determined according to the extent of the loss. If the property value falls as a result, compensation equals that fall.

The Detailed Principles of Preparing and Executing Public Road Construction Investment Projects Act adds another two exceptions, both of which were introduced in 2009 in order to speed up the process of public roads building.

The first exception deals with situations when residential properties (houses or blocks of flats) are expropriated. If so, the owner of such property or flat is given an additional 10,000 zł (≈2500€). The second exception concerns property owners that hand the properties over to road authorities within 30 days of informing them that the expropriation decision has been made. In such situations the amount of compensation is increased by 5%.

All the rules regarding compulsory purchase compensation determination presented above demonstrate that the constitutional principle of just compensation in many cases is not fulfilled (Chart 2).

Chart 2: Just compensation in practice

SCENARIO I					
	MARKET VALUE	ADDITIONAL COSTS	LOST PROFITS	CHANGE OF VALUE	OTHERS
RESIDENTIAL PROPERTY	✓				
COMMERCIAL PROPERTY	✓		✓		
AGRICULTURAL PROPERTY	✓				
SCENARIO II					
	MARKET VALUE	ADDITIONAL COSTS	LOST PROFITS	TIME*	OTHERS
RESIDENTIAL PROPERTY	✓				✓
COMMERCIAL PROPERTY	✓				
AGRICULTURAL PROPERTY	✓				
*Lost profits up to reconstruction in new location					
✓	INCLUDED ELEMENTS				

Author's own study

In many situations the realisation of public purpose investments, especially public roads, leads to conflicts between the expropriated owner and the public authority. Conflicts that quite often cause whole investment delays. The need of change in compensation determination rules has been indicated for a long time by specialists directly connected with expropriation procedures (surveyors, valuers) and academics. The Polish parliament has already started preparing some changes in this respect, which has led to a comparative study of solutions adopted in other countries being carried out by the authors of this monograph.

## 5. PARTICULAR RULES OF COMPULSORY PURCHASE COMPENSATION DETERMINATION ADOPTED IN OTHER COUNTRIES

In order to make a comparative study of particular compulsory purchase compensation rules adopted in other countries, a compulsory purchase questionnaire study has been conducted mainly among participants of previous FIG conferences. Over 50 questionnaires have been sent to 28 countries. The answers received (15 respondents from 11 countries) were used to form the following conclusions:

1. In most countries (9 out of 11) the market value draws the lower border of the compensation amount
2. There are also rules stipulating that the amount of compensation cannot be greater than expected by the expropriated owner and not less than proposed by the public authority
3. Other elements are also compensated including other losses, additional costs, lost profits - in this case, Polish regulations differ considerably from other countries' regulations (Chart 3)

*Chart 3: Elements forming compulsory purchase compensation in other countries*

COUNTRY	ELEMENTS FORMING COMPENSATION		
	THE VALUE OF RIGHTS	LOST PROFITS	ADDITIONAL COSTS
Australia	✓	✓	✓
China	✓	✓	
Cyprus	✓	✓	✓
Finland	✓	✓	✓
Canada	✓	✓	✓
Germany	✓	✓	✓
Norway	✓	✓	✓
New Zealand	✓	✓	✓
Poland	✓	✓ (partly)	
Sweden	✓	✓	
Taiwan	✓		
Turkey	✓		
Hungary	✓	✓	

*Source: "Questionnaire on compulsory purchase"*

The regulation stipulating property use allowance as being dependent on the influence investment may have on property value (increase or lack thereof), is a solution adopted only in Poland. In most countries (Cyprus, Turkey, China, Taiwan) a "point guard" rule applies, according to which the increase of property value caused by the investment must not be taken into consideration while estimating the amount of compensation (Questionnaire on compulsory purchase).

In this context, market value forms the basis of compensation in all of the countries except Taiwan, where the basis of compensation forms cadastral value – which in theory equals the market value but in practice, is lower because it is not updated annually.

In many countries, in order to estimate the value of the property, a comparative approach is used (sometimes income or cost approach) (Chart 4).

Chart 4: Approaches used for market and cost value estimation in other countries

COUNTRY	COMPARATIVE				INCOME			COST			
	1	2	3	4	5	6	7	8	9	10	11
China	✓	✓	✓		✓	✓				✓	
New Zealand	✓				✓	✓					
Taiwan	✓				✓			✓			
Finland	✓	✓	✓		✓	✓		✓	✓	✓	
Australia	✓				✓				✓		
Hungary	✓			✓*		✓		✓			
Norway	✓				✓			✓			
Cyprus	✓	✓			✓	✓					✓**
Sweden	✓	✓	✓		✓	✓		✓	✓	✓	
Turkey	✓										
Germany	✓	✓	✓		✓	✓		✓	✓	✓	

1. Pair sales comparison
2. Sale price correction
3. Market statistical analysis
4. Other
5. Direct capitalization
6. Discounted cash flows
7. Other
8. Detailed technique
9. Technique of joined elements
10. Index technique
11. Other

\* The base of the method is the AK value that belongs to the quality classes, to which multipliers are connected at all times  
\*\* Assigned to be estimated by expert Quantity Surveyors of the government.

Source: "Questionnaire on compulsory purchase".

Poland and Canada have the same principle concerning properties that have a limited market (for example schools, churches, hospitals). In terms of this type of property expropriation, the cost value forms the basis of compensation. The difference between the two countries is that in Canada, when the expropriated party decides to recreate expropriated property and expends the designated monies does it within twelve months, the value of the cost value of the property is not decreased by its depreciation (Żróbek S. 2008). In most countries the same solutions function when it comes to estimating lost profits (Chart 5).

Chart 5: Means of estimating lost profits in other countries.

COUNTRY	MEANS OF ESTIMATING LOST PROFITS
China	Income approach
New Zealand	Assessed after business has moved once sufficient time has elapsed to enable extent of loss to be quantified. (accountants and expert advisors assist). Comparison of sales figures before and after works and capitalisation of difference
Taiwan	-
Finland	The cash-flow method; Yield capitalisation is the most common technique, especially in expropriations concerning agricultural and forestry units; Typically based on analysis of book accounting and income statements. The conveyor must show which costs incur. Typically a statement from an accountant is required. In practise the losses are compensated for a maximum of 5 years, thereafter the business is expected to have adjusted or moved to another location (which can be compensated).
Australia	Present value of defined profits lost for a designated period of time.
Hungary	Discounted Cash flow; The owner is to receive a full and adequate indemnification for the real estate. The point is that the owner should not find himself into a situation more disadvantageous than prior to indemnification.
Norway	Direct estimation of losses per year – capitalized (5 % normally). Yearly loss may be reduced by the usual possibilities for the owner to reduce his losses over time (adaption to the new land situation).
Cyprus	Total Earnings Method, Dual capitalization Method, Super profits Method, Capital Earnings Method
Sweden	Income cost methods.
Turkey	-
Germany	An orientation is provided by the Compensation Guidelines Agriculture (LandR), but it is not obligatory. There are specialized valuers for agriculture, listed at the Landwirtschaftskammer (self-governance of agriculture). There are also specialised valuers for resettlements of firms (listed at the Chambers of Commerce and Industry).

Source: "Questionnaire on compulsory purchase"

The results of the compulsory purchase questionnaire research confirmed all the conclusions drawn by other researchers that hitherto dealt with the same topic - Richard Grover, Iona Anghela and others (Grover et al. 2008), Kauko Viitanena (Viitanen et al. 2008).

## 6. CONCLUSIONS

1. The interpretation of just compensation and the analysis of principles concerning its determination with a comparison of solutions adopted in other countries have demonstrated the urgent need of changes in Polish detailed regulations
2. Polish regulations of compulsory purchase compensation determination do not fulfill the 'just compensation principle'
3. There is no integration of compensation rules determination on the international arena
4. Positive changes that could be initiated by the FAO, applying the following basic principles in respect to compensation:
  - **Equivalence:** those in question should be paid no more and no less than the loss resulting from the compulsory acquisition of their land

- **Balance of interests:** the process should safeguard the rights of those who lose ownership or use of their land while at the same time ensuring that public interest is not jeopardised
- **Flexibility:** the law should be specific enough to provide clear guidelines but flexible enough to allow for the determination of fair compensation in special cases. Legislators cannot foresee all possible scenarios and a rigid application of detailed provisions may result in owners not being compensated for losses that are not identified in the regulations
- **Equal application to de facto and de jure interests:** the principle of equitable compensation should be applied equally to the loss of land, whether it is land that is titled and registered, land held under customary tenure, or land in informal settlements
- **Fairness and transparency:** the negotiating powers of the acquiring agency and those affected should be as equal as possible, and should be based on an open exchange of information (FAO 2008)

It is obvious that in forming a well organised and commonly accepted expropriation system will not be an easy task. Nevertheless, there is an urgent need for this because it is the only way one can eliminate the conflict between property owners and public authorities, thereby speeding up public purpose investments. In this respect one ought to consider solutions adopted in other countries, taking advantage of appropriate fora such as FIG, for the purposes of exchanging relevant experience and information.

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