

The Land of Make Believe: An Overview of the Assessment of Compensation for Land Taken on Compulsory Acquisition in the United Kingdom

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SUMMARY

In the United Kingdom (UK), the assessment of compensation payable following the compulsory acquisition of land is laid down in statute. This paper discusses how the UK legal provisions for compensation payable on compulsory acquisition for land taken sacrifice the rights of the individual claimant to the greater good of the wider public by ensuring that an acquiring authority does not pay compensation for any value which it creates through the scheme underlying the acquisition or the development of land. The valuer is, therefore, required to imagine and then value the property in a “no scheme world”, which ignores both the reality of the acquisition and any benefits recognised by the open market of the development associated with it.

Thus, in such cases, the claimants are unlikely to receive the true open market value of their property and are therefore unable to be able to replace the property acquired with one of a similar market attributes and therefore value. This situation is compared with that of other land owners from whom no land is taken, who are able to benefit from the full increases in value resulting from the scheme and which are recognised in the open market. The paper also considers a similar inequitable situation where part of a development site is acquired which is undevelopable as a separate site. The debate is developed into how a system of betterment taxation could resolve the clear inequity within the UK system.

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1. INTRODUCTION

This paper provides an overview of the method of assessing compensation on compulsory acquisition (eminent domain) in the UK. It does not deal with process of acquiring compulsory acquisition powers (which is laid down in statutory legislation) nor does it discuss the process of fixing compensation for losses unrelated to land value such as disturbance. Instead, it focuses on the valuation problems which the law has created over time and which can often result in the landowner being paid less than true open market value of the property taken or being placed in a position where the value of a landholding after compulsory acquisition, plus compensation, is less than the value of the landholding before the acquisition.

This situation arises because the law does not seek to achieve “financial equivalence” i.e. the claimants gets no more and no less than they lose. Instead, a series of “rules” within the compensation code which the valuer and the courts are required to follow, ensure that the betterment value created by the acquiring authorities’ scheme is denied to some owners, but retained by others.

The title of the paper “the land of make believe”, comes from a judicial decision (*Myers v. Milton Keynes* 1974) in which the judge stated that, in fixing the level of compensation, “the valuer must let his imagination take flight to the clouds, he must conjure up a land of make believe”. This demonstrates the result of decades of legislative changes affecting both planning and land taxation, which have resulted in a confused and inequitable treatment of the development value of landed property.

References in this paper are made to standard textbooks and also to case law. In addition, web sites giving further details of the subject are also included for those who wish to research the matter further.

2. BACKGROUND TO COMPULSORY ACQUISITION AND COMPENSATION PROVISIONS

The taking of anything from anyone without their permission is theft and is punishable within the courts. However, the British Parliament will allow the “theft” of landed property by specified bodies, only if sufficient public benefits will result, both from the acquisition and from the resulting development on that land. Thus, fundamental to all compulsory acquisitions is the need for Parliament to authorise:

- the body to undertake the acquisition;
- the acquisition of the land for the purpose for which it is acquired;
- the procedure to be adopted;
- the use of compulsion; and
- the payment of compensation.

For the purposes of this paper, it is the Parliamentary authorisation of the payment of compensation which is crucial. Compulsory acquisition is a process which only exists as a result of Parliamentary (statutory) legislation: thus, the right to receive compensation as a result of compulsory acquisition must also exist in statutory legislation. The corollary is that if statutory legislation does not specifically authorise the payment of compensation for a particular loss, the landowner (or claimant) is entitled to nothing.

The statutory legislation for compulsory acquisition in the UK dates back to the 19th century. Indeed, in some cases, current legislation is derived directly (by a consolidating Act of Parliament) from 19th century legislation. However, at that time, while the situations in which compensation would be payable (which included land taken and depreciation in the value of land retained when land is taken) were specifically identified in statute, the level of compensation was left to the courts to decide and the courts took the view that compensation should be based on the loss to the owner.

In 1919, legislation shifted the basis of compensation to market value and the current legislation (s. 5 Land Compensation Act 1961, which stems directly from earlier 1919 provisions) provides that compensation for land taken must be “. . . the amount which the land if sold in the open market by a willing seller might be expected to realise.” This section also specifically excludes any additional compensation payable on the grounds that the acquisition is compulsory; any additional compensation because the land is needed by an authority possessing statutory powers; and also any value attributable to an illegal use..

However, despite the apparent clarity of this wording, other provisions within the legislation combine to ensure that this definition of “open market” value will, in many circumstances, ensure that claimants receive less than their loss. This is discussed further below.

3. “OPEN MARKET” VALUE FOR THE PURPOSES OF COMPENSATION

There is, for valuers, a very clear and unambiguous recognition of “market value”, which is contained in a number of valuation standards, including the International Valuations Standards (IVSC, 2003) and the Appraisal and Valuation Standards of The Royal Institution of Chartered Surveyors (RICS, 2003). This latter tome defines ‘market value’ as:

The estimated amount for which a property should exchange on the date of valuation, between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

The fact that the true nature of the acquisition is one of compulsion, does not prevent a valuer from estimating the “market value”, based on actual transactions in the true open market,

which will provide the evidence on which to base an opinion of the value of the property which is being acquired. This is something with which valuers are very familiar and it is well-recognised within compensation provisions that it is the opinion of a competent valuer which is the basis on which compensation is to be fixed.

3.1 Financial Equivalence

However, other legislative provisions combine to ensure that the acquiring authority does not benefit from any reduction in value which it causes, despite the fact that such value (or its absence) may be reflected in the true open market. Thus, a valuer is required to ignore any depreciation in the value of the land as a result of the threat of acquisition. This seems reasonable – it is not the landowner’s fault that the threat of acquisition has depressed the market value of the property, and so the compensation awarded should not be reduced as a result. The claimant should (one would expect) get, by way of compensation, the open market value of the property, assuming no depreciation has been caused by the acquiring authority.

The fundamental concept should be one of financial equivalence – that claimants gets no less and no more than their loss. From the claimants’ point of view, this is likely to mean that they are able to replace the property which is being taken with one of similar attributes and paid for entirely out of the compensation they receive for the land taken. In other words, they should be able to use the compensation to buy a comparable property and, with the exception of the disruption, be left in substantially the same position as if the acquisition and relocation had not happened.

3.2 No Scheme World

In addition to ignoring any depreciation which the acquiring authority’s threat of acquisition causes to the value of the land, valuers are also required to ignore any increases in value caused both by the acquiring authority’s acquisition and any actual or proposed development which will be undertaken in pursuance of the “scheme”, except that which would reasonably have occurred in the absence of the “scheme”.

Legislation (s. 6 and Schedule 1 Land Compensation Act, 1961) requires that valuers ignore any increase in value due to actual or proposed development undertaken within a range of defined areas, including the entire area which is being compulsorily acquired together with the claimant’s land (the area covered by the Compulsory Purchase Order¹). Also, if the acquisition is for the purpose of a New Town, then it is the entire New Town development which is or will be undertaken (and the increased value which it generates) which is ignored.

In addition to these specified (Schedule 1) circumstances, there is judicial authority for extending this principle to “the scheme underlying the acquisition” (*Pointe Gourde Quarrying and Transport Co. v. Sub-intendant of Crown Lands* 1947). Thus, provided it can be established that the property has increased in value as a result of the “scheme” underlying

¹ the ministerial order which forms a part of the Parliamentary authorisation for compulsory acquisition

the acquisition (however that is defined), then this added value must be excluded from the compensation payable, regardless of how large the scheme is.

The logic behind this is clear – the acquiring authority does not have to pay for any increase in value (or betterment) which it has created by its actions. It pays only the level of compensation which reflects the open market value of the claimant’s property had there been no compulsory acquisition and no resulting development. There is a rationale behind these provisions. The acquiring authority is likely to be funded by public money, provided by the general taxpayers, so there is a public accountability issue here.

However, while the legislation requires that valuers, who fix the level of compensation to be paid to a claimant, imagine the amount which would be paid for the property in the open market but in the absence of the acquiring authority’s acquisition and development, the claimant is left to purchase what should be a comparable property in a market which DOES reflect the value of the acquiring authority’s acquisition and development. In areas where land is being acquired to regenerate or otherwise improve a locality, and where land is acquired for this development at different points in time, it is not unusual for early development to have a positive effect on the market value of existing and neighbouring properties. As the acquisition and development programme progresses, people see the physical environment in the area improving and, as a result, the property market is stimulated and property prices increase most notably in the surrounding areas which are not going to be acquired.

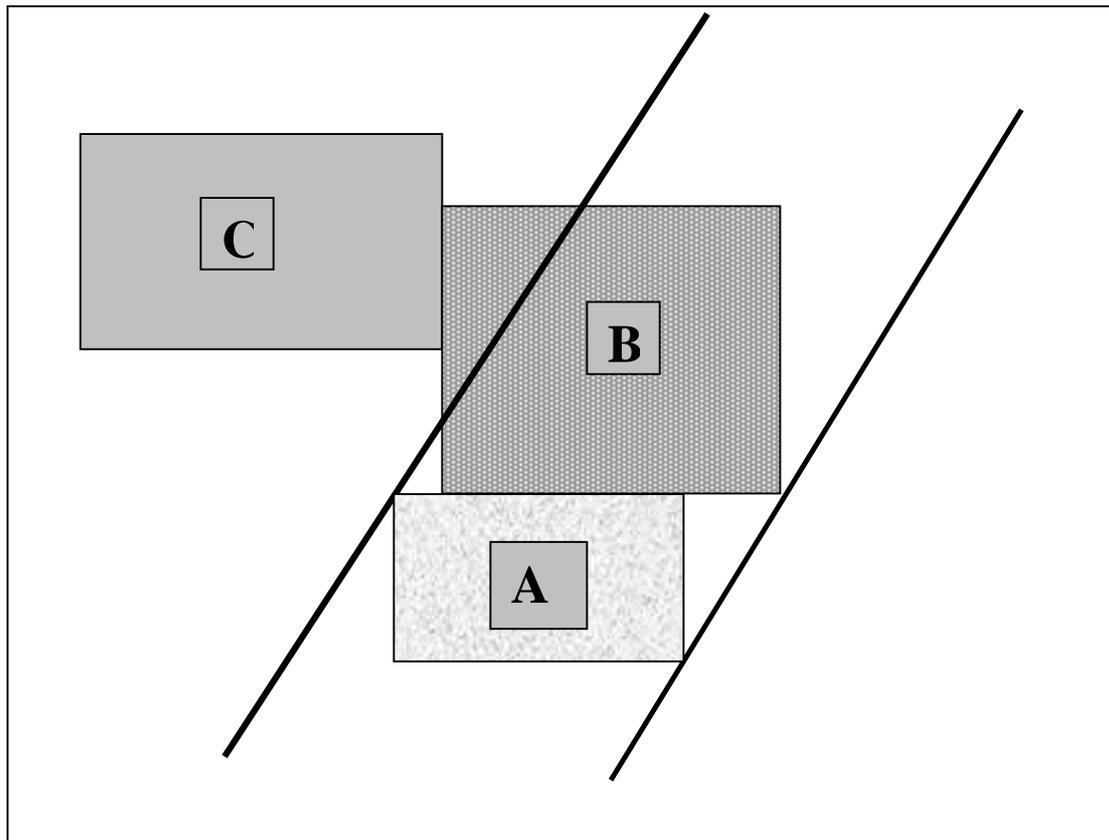
Frequently, therefore, owners whose land is to be compulsory acquired see similar properties, often outside the development area, increasing in value as a result of the development, and anticipate such an increase in value in their compensation. The statutory provisions operate to ensure that such an increase in value (although reflected in the true open market) is ignored in assessing the level of compensation. This frequently means that such claimants are unable to use their compensation to purchase similar properties and yet, but for the statutory requirement that compensation is to be fixed in a “no scheme” world, if compensation were based on the true open market value of the property, owners would be able to purchase a comparable property. For such a claimant, the legislation ensures that there is no financial equivalence and the level of compensation paid can therefore, be described as unfair.

4. SET OFF OF BETTERMENT

Statute authorises the payment of compensation for land taken and also for any depreciation in land which is retained by the claimant. But where the land retained increases in value as a result of the acquisition, there are provisions which allow the acquiring authority to reduce (or even wipe out) the compensation payable to the claimant. An example best illustrates this situation.

Suppose a new road is to be built around the outskirts of a town. Most of the land being acquired is currently used for agricultural purposes but once the road is completed, there will be the potential to develop some of the surrounding land for light industrial purposes. Three farmers own land which will be affected by this development, as shown in Figure 1.

Figure 1:



Parallel lines indicate the area to be compulsorily acquired for a new road.

Owner A is losing all of the land to the acquisition;
Owner B is losing some of the land to the acquisition;
Owner C is losing no land at all to the acquisition.

Owner A owns land which will be totally acquired for the scheme. Legislation ensures that compensation will be based on one of a range of planning assumptions, including existing use, the use to which the acquiring authority will put the land and also the use for which the land is designated in the appropriate local authority development plan. Compensation will be based on the most valuable of these options. In our example, the most valuable use is existing use – agricultural – and the claimant will have compensation fixed assuming that use. There is likely to be little controversy here – if there were no scheme to acquire the land and build a road, and Owner A were to sell the land, he would get no more than is currently being proposed in compensation..

Owner B is also losing land to the scheme and it is likely that the compensation for land taken will also be assessed on the basis of existing use or agricultural value. Again, this should cause no concern. However, if the construction of the road brings the likelihood that the

surrounding area will receive planning permission for development, then it is probably that the remainder of B's land will increase in value. Legislation (s. 7 Land Compensation Act 1961) requires that the acquiring authority assesses the amount by which the land retained will increase in value as a result of the development. Let us assume that the land retained increases in value by £50,000 overall. If the compensation payable for land taken is £80,000 then Owner B will have the increase in value (the betterment) caused by the prospect of development set off against the compensation for land taken and will only receive (£80,000 - £50,000) £30,000 from the acquiring authority. If the increase in value to the land retained due to the prospect of development is £100,000, then the claimant will receive (£80,000 - £100,000) no payment at all from the acquiring authority. Owner B will not, however, be required to pay to the acquiring authority the "profit" made on the land retained.

It can be argued that this is fair, on the grounds that Owner B has done nothing to earn the increase in value in the land retained and therefore has no moral right to it. The increase is entirely the result of the acquiring authority's construction of the road and the likely prospect of a public body (the local planning authority) awarding planning permission, to which the market attaches value. It is, therefore, the public authorities (in the form of the acquiring authority and the planning authority) which have created the additional value of the land (at some expense to the taxpayers), and therefore it is fair that they should take back some of that value for the public purse.

However, the situation of Owner B must be compared to the situation of Owner C. Owner C is not losing any land to the scheme. Yet this land too is likely to benefit from the prospect of development potential and therefore enjoy an increase in value. However, because Owner C is not losing any land to the new road, there is no compensation against which to set off the increase in the value of land. Also, despite the fact that planning permission (which is a fundamental component of the value of land) is awarded entirely at the discretion of a public body (the local planning authority), there is no general provision for public bodies to take back any of the value that the grant of planning permission creates. Owner C, therefore, keeps all of the development value which the construction of the road generates and, if planning permission is granted on the land, Owner C will also be able to realise the full development value.

This is clearly inequitable. If Owner B is denied development value (up to the level of compensation payable for the land taken), then Owner C should not be permitted to enjoy all of the development value which attaches to C's land. If it is right at Owner C should enjoy all of the development value which attaches to the land, then so should Owner B, and that increase should not be set off against the compensation payable for the land taken.

5. TAXATION OF BETTERMENT

It is the very selective nature of these provisions which causes the inequity, and it exists largely because the UK does not have a general provision to tax betterment (which was defined by the Uthwatt Report 1942) as;

any increase in the value of land (including buildings . . .) 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.

With the exception of the set off provisions described above, the only measures which will claw back some of that increase in value are:

- the local government tax on the occupation of land (Rates) (although agricultural land is exempt this tax, so it will only apply once land is developed); and
- Capital Gains Tax, which is levied at 40% on the increase in value (sale price less purchase price – with an allowance for inflation) during the period of ownership.

Several attempts have been made over the 20th century to introduce a general system of taxing betterment value, including the nationalization of all development value in 1947 and the levying of a betterment charge in 1967.

The most recent, the Community Land Act 1975, proposed that all land should change hands at existing use value, except for development land which would be sold at existing use value to the local authority, which would then sell it on to be developed at a value which reflected its development potential. That way, the public authority which increased the value of land by the grant of planning permission would benefit from that increase in the profits made from the sale of development land. Before the scheme could be fully introduced, a temporary Development Land Tax was introduced in 1976, which taxed development value (as identified in the Development Land Tax Act) at 60%. However, during the 1980s, both statutory provisions were repealed.

In the UK, the taxation of betterment is, in part, a moral and therefore a political debate, and the earlier provisions described above, were all repealed following a change of government. However, the moral debate is clear. It is the community which creates the betterment value in all of its many forms, most notably in the grant of planning permission. Provisions exist for the community to pay compensation for any depreciation it causes to the value of land through the construction and use of public works. It is therefore logical to conclude that the landowner has no right to any of this betterment value, unless such a value is due to the landowner's own efforts, for example, in the form of construction or improvement of the land or any buildings on it.

If the community could recoup such betterment value, and if it were to be spend by the public authorities on maintaining, improving and expanding public services, then the whole of the community would benefit and all of the properties within that community would be improved by increases in value.

However, the most important issue within the payment of compensation is the inequity of treatment, as illustrated earlier. It is also clear that public hostility to compulsory acquisition (which may, in part, reflect their dissatisfaction with the level of compensation paid) also

causes long and expensive delays in a number of public schemes. It may be cheaper and more equitable in the long term to pay claimants development value for their interests in land, both in order to ensure that they do received financial equivalence and also to speed up the acquisition and development processes.

The treatment of betterment can then be considered in a national context, rather than in a specific and selective manner as is currently the case.

6. THE “HOVERINGHAM GRAVELS” PROBLEM

A similar inequitable situation arises if an acquiring authority compulsorily acquires development land and in so doing causes injurious affection not to the land retained but to the land acquired.

The intention of the 1961 Land Compensation Act is that when land is compulsory acquired an expropriated owner is compensated subject to special valuations assumptions. For example where value is attributable to the scheme underlying the acquisition, as stated above, this amount has to be discounted which can be seen to be both impractical in valuation terms and inequitable. With the acquisition of development land, however, the physical characteristics of the acquired land will have a major influence on the compensation awarded to the original owner.

When land suitable for development is acquired the valuer first has to consider the planning assumptions which can be made. These are stated in Ss 14 – 17 of the 1961 LCA and will include any existing planning consent, development plan zoning and development for the purposes of the acquisition. Even with a ‘valuable’ development assumption, however, the valuer has to value the land acquired in its actual physical state in isolate and which is not part of the original holding.

The reason for this lies in the construction of the legislation which deals with claims for land taken (s. 5 Land Compensation Act, 1961) and which deals with claims for injurious affection (s. 7 Compulsory Purchase Act, 1965) which deals with claims for compensation for injurious affection. If the development land acquired is a less attractive development proposition than it was as part of a larger site, perhaps as the land acquired is a narrow strip, the CPO has effectively caused injurious affection to the land acquired (for which no compensation is payable) rather than to the land retained (where compensation is clearly available).

Arguably this loss should be compensated but the courts have interpreted Section 7 to mean that injurious affection can only be claimed for injurious affection to the land retained by the claimant. The point was considered in *Hoveringham Gravels v Chiltern DC* (1977) when Lord Justice Roskill said that injurious affection caused by severance is a head of compensation for the land owner “by reason of other retained land of his being less valuable to him through that retained land being severed or otherwise injuriously affected by the compulsory acquisition of the land taken”. In other words, the head of claim for injurious

affection caused by severance must related to depreciation in value of the retained land and not on the land acquired.

The unfairness caused by the construction of s. 7 of the Compulsory Purchase Act could be dealt with if claims for compensation could be made on an overall basis rather than by identifying the claim for land taken and the claim for injurious affection separately. If this was allowed the claimant's interest in the land before the acquisition could be valued and from this could be deducted the value of the interest after the acquisition. Section 4 of the 1961 LCA Act, however, requires separate heads of claim and a "before and after" valuation is therefore unacceptable.

It may be thought that such an obvious anomaly should have attracted the attention of legislators but recent cases show that the inequitable situation continues. The point was considered in *English Property Corporation plc v Royal Borough of Kingston Upon Thames* (1998). The point was clearly made in this case that "There was nothing to displace the normal rule that the land retained, like the land acquired, was to be valued as at the date of entry in its actual physical condition as at the date of the notice to treat". Draft legislation currently being considered in the UK Parliament suggests that legislators are minded to allow claims for injurious affection caused by severance of development land and it is suggested that the most appropriate way to bring this about would be by the use of a "before and after" valuation to arrive a claimant's true loss.

7. SUSTAINABILITY AND REFORM

The earlier UK experience makes it clear that a successful betterment tax must be seen to be acceptable to all major political parties so that there is a clear policy which will not change if the party in government changes (so that landowners do not withhold land from the market in order to avoid the tax in the hope that the tax will be repealed by some future government); it must be administered by a group of specialists who are competent and focused in their role of dealing with betterment taxation (refer, for example, Plimmer *et al.* 2002); and the revenue must be and be seen to be totally for the benefit of the community.

It is entirely appropriate that such a policy should be an integral part of a sustainable community that a community should be able to benefit directly and indirectly from its ability to create value, just as it is prepared to compensate those who are disadvantaged as a result of its destruction of value. There are a number of options which could be used to ensure that the community keeps the development value it creates. Some of the more drastic ones include the nationalization of all development value; the conversion of all freehold interests into 99 year leases, as the end of which all interests in land would change hands at existing use value only and only the community (central or local authority) could sell land at a development value. All of these are radical proposals and likely to be highly unpopular in the UK.

Any future betterment tax would not need to be levied at 100%. Indeed, there are good reasons for introducing such a tax at a rate which allows some of the development value to remain with the landowner. However, in such circumstances, the level of compensation paid

on compulsory acquisition must also allow claimants to keep a similar level of betterment value as if they were being taxed. Nothing else is equitable.

Often proposed as a device for securing betterment for the community is the reform of the current rating system in the UK, which taxes land and buildings based on their existing use value (Plimmer, 2003). It would not be difficult to revise such a long-established taxation system to reflect the development potential of property. Some significant amendments would need to be made to incorporate all land into taxation (currently agricultural land and buildings, vacant sites and derelict land are not subject to Rates). Rates, which are now fixed by central government should also be (and be seen to be) under the control of local authorities, which levy the tax, collect and spend the revenue. In this way, minimal reform would be necessary in order to tax all land and buildings at development value. However, this would also mean that improvements carried out and paid for by land owners would also be taxed and such improvements may not always be seen as appropriate for a betterment tax.

7. CONCLUSIONS

The UK government recognises that reform of the system of compulsory purchase and compensation is overdue. However, it seems to be concentrating on reforming the procedures, rather than the substance, and focusing on the system of getting and implementing the powers of compulsory acquisition, rather than the basis of compensation.

The current proposals follow on from a series of earlier consultations which have conveniently excluded large scale reform their terms of reference and hence the betterment issue has not yet been tackled and this together with other inequities remain.

We now have a chance to deal with this issue and build sustainability into an important aspect of the built environment in the UK. Sustainability is about balance and it is about positive contributions to communities and their values. The UK has a severe and chronic shortage of low cost housing and a rigid planning system which prevents development on “green field” sites. Reforms in all aspects of the built environment which can encourage sustainability need to be adopted and adapted for the benefit of all.

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BIOGRAPHICAL NOTES

Dr Frances Plimmer is a Chartered Surveyor and Senior Researcher at Kingston University, Surrey, England, who has extensive experience in researching, writing and speaking on matters of real property taxation both in the UK and overseas. She has lectured on the subject on Compulsory Purchase and Compensation for over 20 years and she has lectured and written on other aspects of statutory valuation, particularly aspects of property taxation.

Currently, she is researching into issues of professional Ethics for an international professional organization and involved in the teaching of research methods to post-graduate students.

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