The epistemology of value in the assessment of just terms compensation

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Compulsory acquisition of land in Australia is predicated on the principles of just terms compensation. Based on these principles, the determination of compensation is subject to various statutes and court rulings. This article examines these principles and moves on to discuss the gaps in parity of compensation and how these gaps affect parties in the compulsory acquisition process. The article also looks at the influence compensation quantum and principles have over the value of properties, discussing how that value is determined and how valuation methods are used. It reviews a survey of dispossessed property owners in New South Wales, Australia, that was conducted to measure the success of the legislation and processes. Finally, the article concludes with an analysis of court directives; it asks whether these contribute to the impasse of points of difference in the assessment of value (and hinder the courts) when in fact they were designed to help Australian courts in expediting compulsory acquisition matters.

INTRODUCTION

As more than a century has passed since the case of *Spencer* v. *Commonwealth of Australia* (1907), it is perhaps appropriate to review the impact and contribution this judgment has had in the compulsory acquisition process and more importantly its impact in establishing the basis of market value. Referred to as the *Spencer* case, the simple but concise attributes of the judgment and definition of market value handed down have stood the test of time and have been adopted by legislators in various statutory definitions of value in the acquisition, rating and taxing legislation throughout Australia. The key components of the surmisal made by the judges in this case are: "... to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land and cognisant of all circumstances which might affect its value, either advantageously or prejudicially ..." (Rost and Collins, 1996).

This definition has been seen by many dispossessed parties as a legal construct for the acceptance of a process in which their decision to be a willing seller is not a consideration. It is this factor that has provided the greatest opposition to the compulsory taking of land.

Section 3(1)(b) of the Land Acquisition (Just Terms Compensation) Act 1991 (the Act) provides: "to ensure compensation on just terms for the owners of land that is acquired by an authority of the State when the land is not available for public sale". While dealing with the issue of the sufficiency of compensation, the justification for the compulsory acquisition of land is enshrined in the principle of the competing needs of the individual versus the needs of the community in which the purpose of the acquisition will serve.

WILLING OR NOT WILLING TO TRADE

Despite the fluency of the definition, which constitutes a hypothetical "willing buyer,

willing seller" scenario in which both parties are willing but not anxious to trade, this hypothesis has met much resistance from dispossessed parties not willing to sell for any price. It is in these cases that a hypothetical framework is adopted by the courts in the assessment of compensation on just terms. A further level of complexity is added to the acquisition process when distinguishing the difference between a genuine potential dispossessed party not wishing to trade at all and a potential dispossessed party seeking a ransom value (value in excess of market value) for a property.

Regardless of the circumstances of the affected party, state and Commonwealth of Australia legislation permits land to be compulsorily acquired for a public purpose. In exchange for an interest in property, Article 17 of the Universal Declaration of Human Rights states: "(1) Everyone has the right to own property alone as well as in association with others. (2) No one shall be arbitrarily deprived of his property" (United Nations, 1948). In New South Wales (NSW), Australia, the compulsory acquisition of land occurs once a notice to acquire is approved by the governor and advertised in the *Government Gazette*. Brown (2004) highlights that at this point all interests in the acquired land are vested in the Crown and the owner's interest is converted to a claim for compensation. This process is further defined by Jacobs (1998) who refers to Section 20 of the Land Acquisition (Just Terms Compensation) Act 1991 (NSW), which discharges all interests in the land, including dedications, reservations, easements, rights, charges, rates and contracts in, over or in connection with the land.

Prior to the compulsory acquisition process, all acquisition legislation in Australia provides for acquisition by agreement, in which the relevant government authority must attempt to acquire property by agreement. It is not until this process is exhausted that the compulsory process will commence. Despite the best efforts of an acquiring authority to negotiate the purchase of property, a small percentage of dispossessed owners choose not to negotiate or proceed through negotiation and the acquisition will proceed through the compulsory process. Whether the acquisition is achieved by negotiation or the compulsory process, valuers on each side are engaged to assess the value of the interest to be acquired. Their approach, method and supporting market evidence are important factors in determining whether the acquisition is achieved by negotiation or by compulsion.

In Australia, there is individual legislation for each state and the Commonwealth of Australia for the acquisition of property. In NSW, the Roads and Traffic Authority (RTA) is the largest acquirer of land in the state. While most land is acquired by negotiation, the RTA (2005) highlights that less than 10 percent of land acquired by the RTA is undertaken through the compulsory process, which in turn proceeds to court. In some cases, settlement is achieved during the mediation process and matters of differences are resolved to the mutual satisfaction of the parties. In many cases that do proceed to court, the most common issue of contestation concerns the quantum of compensation. In many cases, the issue of compensation goes beyond monetary amounts to include issues of the impact of the use of the acquired land in the case of partial takings and the ability to relocate in the case of marginal-value properties.

THE NATURE OF THE ACQUISITION AND THE ASSESSMENT OF VALUE

The basis of a claim for compensation will depend on the acquisition, the impact of the acquisition on the dispossessed party and – in the case of a partial acquisition – the impact that the taking of the land has on the land retained by the dispossessed. The nature of the claim will have an impact on the heads of compensation claimable and most importantly will drive the valuation methodology used in the assessment of compensation. Figure 1 distinguishes the differences in terms of heads of compensation and method of assessment

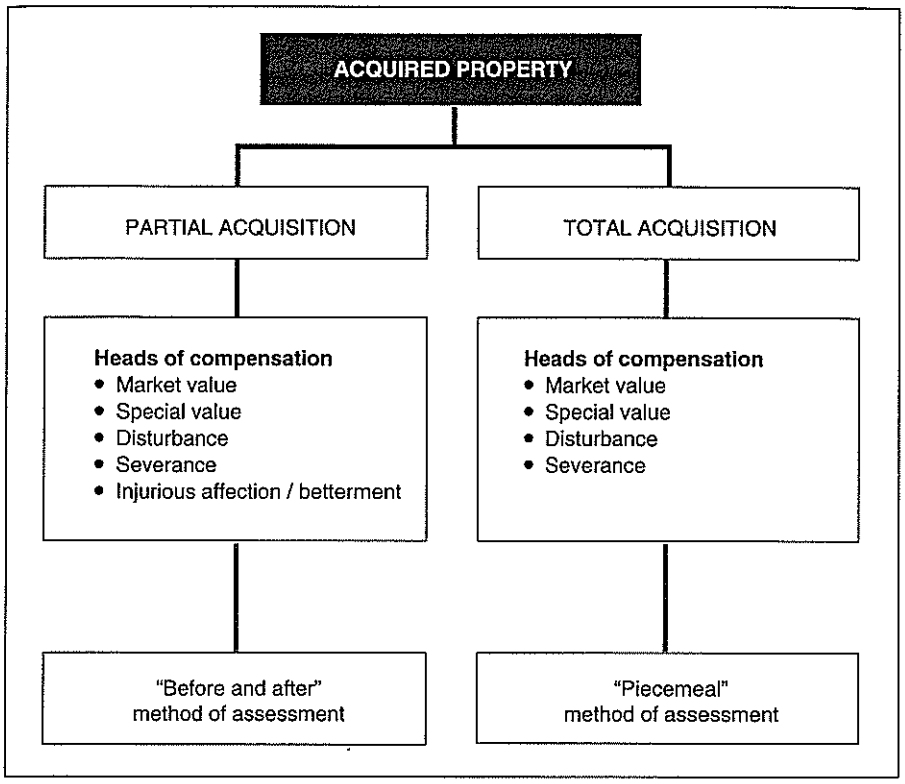

FIGURE 1
Total versus partial acquisition approach

between claims related to partial and total acquisition.

The acquisition of land and the extent of the acquisition are primarily determined by the requirements of an acquiring authority. An acquiring authority is not compelled to acquire any more land than is required for the public purpose. Case law prohibits the taking of any additional land than is required for the public purpose as defined in *Minister for Public Works (NSW)* v. *Duggan* (1951) 83 CLR 824 and *Thompson* v. *Randwick Corporation* (1950) 81 CLR 87. However, the State of Tasmania has the statutory power to enter into agreement under Section 10 of the Land Acquisition Act 1993 to acquire more land than is required by agreement. In NSW, it is not uncommon for an acquiring authority to negotiate the acquisition of the total property (particularly in the case of residential property) where a partial acquisition has been proposed and is not in the best interest of the dispossessed party. Figure 1 evidences that in partial acquisitions of land an additional head of compensation – injurious affection/ betterment – is to be considered and that the method of assessment differs from that for total acquisition. In the case of total acquisition, the "piecemeal" formula for this approach is: Market value + Special value + Disturbance + Severance = Sum of compensation.

This formula requires the addition of the sum of each element of compensation payable. This model assumes all of the heads of compensation are payable. However, this is to be determined on a case-by-case basis. In the case of the partial acquisition of land, injurious affection or betterment is also to be considered and assessed in the compensation. This method adds an additional layer of conceptual complexity in the assessment process and judgement of the valuer. In contrast to the "piecemeal" formula, Hornby (1996) highlights that the "before and after" method is not the sum of values but a judgement of the assessment of the property's value before acquisition and the value of the residual after acquisition, with the difference between the two values constituting the impact of the acquisition on the property retained. This method is not clearly understood by some valuers and property owners who have been dispossessed of part of their property.

The value of the land taken is not the subject of compensation – rather, it is the impact of the taking on the residual property that is the matter to be assessed in partial acquisitions.

ASSESSING VALUE AND THE IMPACT OF THE TAKING

The difficulty with the principle of establishing the market value of the property following a partial acquisition is the measurement of value of the residual land after the works have been carried out. The degree of difficulty in the judgement and assessment of the after value is dependent on the nature of the taking and most importantly the impact of the use to which the land taken is put. Figure 2 gives three examples to underline the different impacts on the same property of a partial acquisition of land

The parcel of land represented in Figure 2 is a 1-hectare block on the urban fringe of a city in NSW that is ripe for residential subdivision and will accommodate 16 separate 500-m² residential blocks of land. In each case, the impact of the acquisition and the use to which the acquired land is put will have a different impact on the retained land.

The subject property in Case 1 requires very little land for the supports of the overhead easement. The primary issue is the impact on the value of the subject land resulting from the visual and any other environmental consequences of the easement use. In Case 2, approximately 10 percent of the land is to be acquired from the front of the property for road-widening purposes, of which the anticipated increase in traffic flow fronting the property is about 5 percent. There will be no change to the permitted entry and exit from the property. In Case 3, the valuation approach is not applicable in NSW as no compensation is payable for land taken beneath the surface of land for an easement. Section 62 of the Land Acquisition (Just Terms Compensation) Act 1991 legislates that no compensation is payable to the party in the case of a substratum, beyond any damage caused to the surface of the property resulting from the works undertaken.

THE IMPRECISION OF VALUATION

As observed from the three cases above, each use has a different impact on the land retained by the affected party. The method of assessment of compensation in Cases 1 and 2 is the "before and after" method. This will necessitate evidence of transactions of similar property with and without the proposed works in order to assess a measure of difference on a "before and after" basis. Despite the simplicity of the descriptive approach in assessing the "before and after method, the non-heterogeneous attributes of property coupled with judgement for adjustments between sales and the subject property render the valuation approach subject

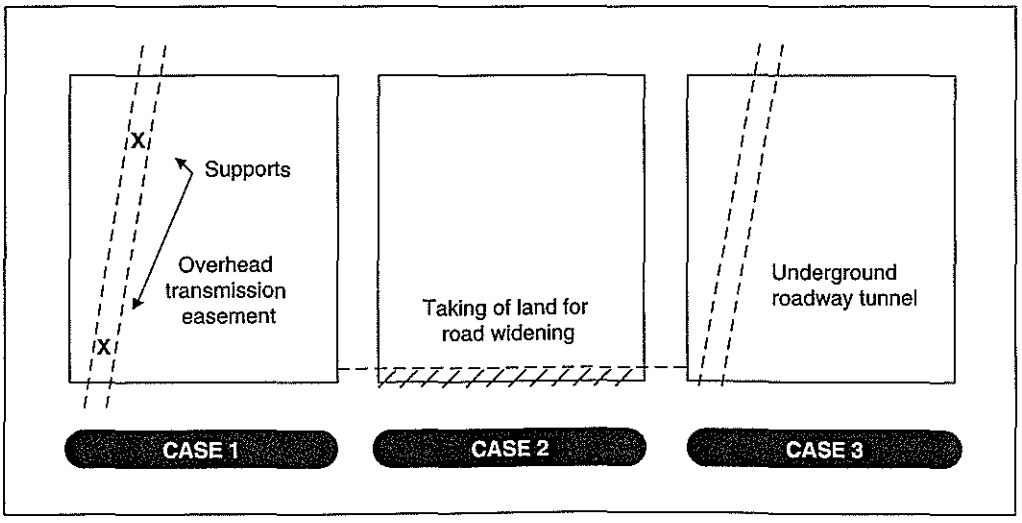

FIGURE 2
Alternate effects on the same property

to imprecision as defined in *Singer & Friedlander Ltd* v. *John D Wood & Co.* (1977) 2 EGLR 84, in which the court stated: "... two able and experienced men, each confronted with the same task, might come to different conclusions without anyone being justified in saying that either of them lacked competence and reasonable care, still less integrity, in doing his work .... Valuation is an art, not a science."

In contrast to the impact of injurious affection highlighted in Cases 1, 2 and 3, the reciprocal of this impact is betterment, which must also be considered in the partial taking of land. In the above three cases, betterment does not apply. However, a valuer assessing the impact of a partial taking must also weigh up the benefits of the use to which the land taken has on the value of the residual land retained. This was defined in *Brell anor* v. *Penrith City Council* (1965) 11 LGRA 156, in which a small portion of land at the rear of a shop was taken to form part of a car park, thus enhancing the value of the residue of the property. In this case, it was shown that the use of the acquired land increased the value of the residual land beyond its value prior to the acquisition and no compensation was determined for the value of the land taken.

There is no specific legislative provision that requires an acquiring authority to take more land than is required for the public works than is required. Despite the absence of such a provision, where the primary activity or use of the land can no longer continue or is affected by the use to which the acquired land is put, the impact of the acquired land may render the residual so heavily affected that the sum of compensation may be close to the value of the whole land. In addressing judgement of total versus partial acquisition, the courts will assess this by quantum where their discretion is limited.

EXTINGUISHMENT VERSUS PARITY OF COMPENSATION – WHAT IS VALUE AND WHEN SHOULD REINSTATEMENT APPLY?

In a number of circumstances, the taking of land through the compulsory acquisition process is inevitable. This is primarily because of the discrepancy in the meaning of value of a property to a dispossessed party and the definition of value as defined in the *Spencer* case highlighted above. For some home and business owners, the acquisition of their property means the extinguishment of their tenement in land, of which the assessment of market value under traditional terms by reference to similar property transaction is not parity of compensation. This is primarily because the amount of compensation offered is insufficient to re-establish the dispossessed parties' freehold tenement. From a residential perspective, it is the extinguishment of a home. In addressing this issue in residential tenancy decisions, the extinguishment of a residential tenancy amounts to more than a process, even when there is no financial interest in the property. The key issue for consideration is the impact of termination, which means having regard to the tenancy and the circumstances of the case. Mangioni (2006) cites the following case: "The Supreme Court of NSW held that a landlord did not have absolute right of possession upon serving a valid notice of termination on a tenant. This precedent was established in *Swain* v. *Residential Tenancy Tribunal* (unreported, Supreme Court, NSW, 22 March 1995, Rolfe J). The court held that s 64(2)(c) of the Residential Tenancies Act 1987 as amended requires the CTTT to consider the circumstances of the case and the tenancy. This decision was appealed to the NSW Court of Appeal, which upheld Rolfe J decision in the Supreme Court, primarily for the reasons stated by Rolfe J. *RTA* v. *Swain* (1997) 41 NSWLR, 452."

The Supreme Court of NSW has instructed the Consumer Trader and Tenancy Tribunal (CTTT) to investigate the reasons for the termination of the tenancy in the *Swain* case. In these cases, the lessee may hold a financial interest through a profit rent or a basic right to occupy land in exchange for rent. While a definitive rationale for the circumstances of the case and tenancy to be considered has

not been provided by the Supreme Court of NSW, it may be questioned as to whether the emergence of a possessory interest in property is recognized. The potential for the possession status of a property may be argued to be encompassed in its market value. However, its importance emerges as a principle for recognition when a party is not a willing seller, as the value of possession to them extends beyond its market value as defined under the *Spencer* test. The missing link in the assessment of just terms compensation is the element of value where a non-willing seller is assumed to be a willing seller in order for the construct of the traditional market value definition to be used to settle acquisition matters. What legislators, courts and acquiring authorities are attempting to do is to define and reduce all interests acquired in land into a financial datum for the settlement of non-commercial interests in land.

This is of greatest concern for those with marginal-value property or property at the lower end of the market in low socio-economic locations and who are not in a financial position to increase levels of debt to accommodate the purchase and finance of alternate higher-value premises. To these dispossessed parties, the value of their dispossession is the security of their environment in which they live and bears no relevance to the *Spencer* principle as the option of being a willing seller would not realistically become an option of choice. In these circumstances, it must be asked whether the objectives of just terms compensation have been applied. To this end, it is questioned as to whether the traditional definition of market value as defined in the *Spencer* case is the primary consideration for the assessment of just terms compensation.

To date, the courts have avoided this issue by reference to the absence of provisions for reinstatement in acquisition legislation. This issue is further defined by Brown (2004), who states: "Any question of compensation for resumed land being based on the cost of purchasing alternative, similar land must depend on the compensation provisions contained in the relevant resumption statutes". The provision for reinstatement is absent in the legislation of NSW.

It cannot be said that the epistemology of value has served those parties it is applied to in the assessment of just terms compensation when the assessment of value is channelled through a narrow conduit of interpretation by reference to transactions that bear little or no reference to the circumstances of the dispossessed. This issue has been raised by Hunt (1998), who, in contrast to the comparability of the property in the sale analysis process, looks at the comparability of the sale. This encompasses additional information, including: the special conditions of the sale; vendor/purchaser/agent motive; method of sale; marketing period; and the market dynamics under which the transaction occurred.

MEASURING THE SUCCESS OF COMPULSORY ACQUISITION IN NSW – A TEN-YEAR REVIEW

The Land Acquisition (Just Terms Compensation) Act 1991 replaced the rigid, inflexible and government-focused objectives of the Public Works Act 1912. Enacted in NSW to ensure expedient acquisition of land through agreement over compulsory taking, the objectives of the Act were reviewed in 2002 to accord with its ten-year anniversary. Prentice (2002) has measured the success of the Act in achieving its objectives. Twenty-three property owners who had their property compulsorily acquired – or who were nearing the completion of this process – were surveyed on a number of key issues.

The 23 property owners were randomly selected from a pool of dispossessed residential property owners. The sample of approximately 3 percent of dispossessed owners gives an indicative opinion only of the success of the legislation. Table 1 summarizes the key findings.

In the above survey, of the 23 parties dispossessed of their property, 19 parties (83 percent) negotiated a settlement with the RTA and 4 parties (17 percent) had their

TABLE 1
Dispossessed residential property owners – survey results

Question	Satisfied	Dissatisfied (%)	Neutral
1. How satisfied were you with the amount of compensation paid?	74	22	4
2. Do you think the timeframe for the acquisition process was suitable?	83	17	0
	Yes	No (%)	Unsure
3. If the underground of your land were acquired for a tunnel or easement, would you expect compensation?	100	0	0
4. Did you object to the amount of compensation that was initially offered by the acquiring authority?	61	39	n/a
5. Question to the 61 percent who objected to the amount initially offered: Did your compensation amount increase?	36	64	n/a
6. In your opinion, do you think that the Commonwealth or State Government should have the power to acquire land?	22	78	0

Source: Prentice, 2002.

property compulsorily acquired, of which 2 cases proceeded to court. In conclusion to this survey, participants were asked to give suggestions as to ways in which the acquisition process and compensation could be improved in the future. The key issues and feedback are:

- In the case of partial acquisition: A majority of the parties who objected to the amount of compensation initially offered were the subject of partial acquisitions and – excluding the amount of compensation – were most dissatisfied with noise and access to their property during the works being carried out and the time taken to carry out the works. The primary issue with partial acquisition was the non-claimable provision for the inconvenience factor experienced during the works.
- In the case of total acquisition: The key issue apart from the amount of compensation was the timeframe for completion of the process.

Of the 23 respondents to the survey, 40 percent did not have any complaints or suggestions for improving the process.

The compelling feedback and observations from this survey show that in general terms the Act was achieving its objectives in the acquisition of residential property. In the cases observed, the primary area of disputation occurred in cases of partial acquisition of land. A further interesting point was the acquiescence of property owners in not fighting the acquisition process once they were aware of the works to be carried out and the impact those works would have on their property.

VALUATION: POINTS OF DIFFERENCE AND EXPEDITING REVIEW

The expedition of resolution in the acquisition process is a primary objective of the Land Acquisition (Just Terms Compensation) Act 1991. In a further improvement over the cumbersome framework of the Public Works Act 1912, Section 3(1)(c) of the 1991 Act provides the following objective: "to establish new procedures for the compulsory acquisition of land by authorities of the State to simplify and expedite the acquisition process".

Timeframes have been provided in the Act to assist with this objective, which requires 90 days' notice to be given of a proposed acquisition and the acquisition must occur within 120 days. A further safeguard has been included in the Act, which allows an acquiring authority to make an advance payment to the dispossessed party after the acquisition has occurred, being the date of gazettal. A safeguard in the acceptance of such an offer is covered under Section 48 of the Act, which states that: "The acceptance by a person of an advance payment of compensation does not constitute an acceptance of any offer of compensation". This provision allows for the dispossessed party to be able to utilize

an advance payment for the purchase of alternate premises rather than being out of the market, particularly if the market is rising. While provision is made for statutory interest to accrue on the compensation amount between the date of gazettal and date of payment of the compensation, this may prove insufficient in a rising market, particularly where the resolution process is protracted and litigious.

In cases of larger landholdings and acquisitions that involve the extinguishment of a business, it is not uncommon for these matters to take up to three times longer than residential acquisitions (The Land and Environment Court of New South Wales, 2006a and b). The Land and Environment Court of New South Wales (the Court) has embarked on the expedition of matters that come before it, in which it refers to this as the process of "case management" in the achievement of this objective. In dealing with matters before it (including compulsory acquisition matters), it has stated: "The overriding purpose of the rules, in their application to civil proceedings, being to facilitate to the just, quick and cheap resolution of the real issues in such proceedings." (The Land and Environment Court of New South Wales, 2006b).

In adopting this approach, the Court has not gone without criticism from those who see it as a resolution mechanism in itself, whereas the Court has sought resolution or at least the establishment of common ground on as many points as possible in order that it might focus on the issues of differences between the parties. In its defence, the Court (The Land and Environment Court of New South Wales, 2006b) has justified its approach by defining its brand of what is "just" in the process: "some think that quick and cheap disposal, by definition, is not just, whereas we think that disposal which is not quick and cheap, by definition, is not just".

RESOLUTION METHODOLOGY

In compensation claims, the Court has sought to expedite the resolution and completion of these matters through its Practice Direction: Class 3 Compensation Claims (The Land and Environment Court of New South Wales, 2006c). In the valuation process, the direction requires expert valuers to confer and provide:

- method of valuation and check method where one has been used;
- full workings, documents relied upon and details of any personal communication relied upon;
- sales relied upon and all relevant information relating to those sales including price, date, area of land and improvements, rate per square metre analysis, zoning and planning controls and comparisons between the sales with percentage adjustments between the sales and the subject property.

Once the above information has been exchanged between valuers, they are to confirm matters they agree upon and identify matters they disagree on; these matters should include:

- highest and best use;
- list of comparable sales agreed upon;
- facts and assumptions upon which the respective valuations are based;
- comparable sales used by each valuer with their analysis;
- percentage adjustments between the sales and their application to the subject.

To ensure that the expert valuers engaged by their respective parties are fully acquainted with the expectations of the Court under the Practice Direction: Class 3 Compensation Claims, expert valuers are required to be served with this direction by their instructing party and sign that they have received it and understand its requirements. Its requirements prohibit the introduction of any evidence not provided in the expert's statement, report or affidavit. Joyce and Norris (1994) define this process as the "anti-ambush rule". In effect, the objective of the proceedings becomes the resolution of the matter, not a decisive win by one side or the other. Procedural fluency in the process through disclosure and articulation of reasoning of the valuation process and evidence used to underpin opinions of value are important. However,

as highlighted in *Singer & Friedlander Ltd* v. *John D Wood & Co* (1977), valuation is not an exact science but an imprecise art that goes beyond the articulation of process to cognitive judgement by the valuer.

CONCLUSIONS

The epistemology of value in the assessment of just term compensation provides a construct in which the commercial assessment of value can be defined in settling compensation matters. In the case of the proposed partial acquisition of land, it may be appropriate to assist the dispossessed party where required by offering a total acquisition of the property. In these circumstances, a true test of value may be achieved through transactions. The first transaction is the agreement to purchase the subject property at its market value unaffected by the acquisition and proposed works. The second transaction is the sale of the residual part of the acquired property after the public works have been completed. This would provide an option and encourage agreement by negotiation where some discretion and choice are given to the dispossessed party. As noted earlier, this may not be perceived as a feasible or affordable option by an acquiring authority.

The reinstatement option needs to be incorporated within state acquisition legislation. It is important that the dispossessed party be placed in the same position as before the commencement of the acquisition process. In achieving this objective, assessment on just terms cannot be made solely by reference to the monetary amount of the acquired home, but by parity of status. While it is important for a context to be drawn in which compensation matters may be defined, this context must not be driven by a process that seeks to dispense with these matters with expedition as its primary objective.

As compulsory acquisition matters come before the courts, the basis of argument supporting the compensation assessed is important. When assessing values, it is essential that valuers establish points of agreement and differences in expediting the resolution process. This can only be achieved when valuers assume the role of determining market value and other relevant heads of compensation from the beginning of their brief. This objective cannot be achieved when valuers act as advocates – regardless of whether they act for the acquiring authority or dispossessed party.

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