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(To FAX 397-2211 - six pages)

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Friday, October 22nd, 1993.

The Secretary,
Technical Committee on Fundamental Rights
Multi-Party Negotiating Process
P.O. Box 307
Isando
1600For the attention of Mrs Miriam Cleary

Dear Madam,

Sub-section 28(2) of the proposed Fundamental Property Rights (Tenth Report):
MARKET VALUE TO BE THE BASIS OF COMPENSATION IN CASES OF
EXPROPRIATION

Thank you for faxing me a copy of the most recent wording of this section yesterday.

1 Proposed AmendmentWould you kindly submit the following amended wording, **emphasized in bold**,
for Section 28(2) to the Technical Committee for consideration:

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- (2) Expropriation of rights in property by the State shall be permissible in the public interest and shall be subject to the expeditious payment either of agreed compensation or, failing agreement, to compensation to be determined by a court of law as just and equitable, **taking into account all relevant factors.** and shall be based on market value and actual financial loss caused by the expropriation.
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2 Motivation

- 2.1 Sub-section 28(2), as currently set out in the Tenth Report, provides for a number of valuation norms to be used, and a "kaleidoscope" of interpretations may result.
- 2.2 The wording in the Tenth Report provides no guidance to the courts as to the

basis of compensation. Which factors are relevant? Should they be economic? Should they be non-economic?

- 2.3 It would seem that the following additional wording set out in the Seventh Report was an attempt to overcome this problem, ie ".....taking into account all relevant factors, *including the use to which the property is being put, the history of its acquisition, its market value, the value of the owner's investment in it and the interests of those affected.*"
- 2.4 While market value can be determined objectively by analysing recent sales of comparable properties and by cross-examination of expert witnesses, some of the other "relevant factors" mentioned are subjective in nature and cannot be similarly tested. These other factors may be inputs in arriving at a market value determination, but the question is: Should they be used as a proxy for determining compensation?
- 2.5 Opportunities may be created by the proposed rights for exorbitant amounts of compensation to be paid, which is unrelated to the actual economic loss suffered.
- 2.6 Similarly, hopelessly inadequate compensation amounting to considerably less than market value may be paid to expropriatees.

Each of the "relevant factors" that are suggested to be taken into account are discussed separately below.

3 **"Relevant factors" that are suggested to be taken into account in the Seventh Report include-**

3.1 **- the use to which the property is being put,**

The use to which the property is being put may be illegal, or it may be unrelated to its potential productivity for a higher and better future use. Value-in-use to an owner is often a subjective matter. This factor seems to be in conflict with the valuation rules set out in both the current South African and British Expropriation Acts.

3.2 - the history of its acquisition,.....

Previous sales transactions of the subject property itself can be part of the market valuation process and the history of its acquisition can be objectively determined in economic terms by examining the Deeds Office records. The possibility exists though that courts may interpret this "relevant factor" in non-economic terms and when read in conjunction with the sub-sections (3) and (4) of the proposed fundamental property rights will amount to effective confiscation of land.

When does history commence? Historic cost and current market value rarely have anything in common.

3.3 - its market value,

Market value is a probabilistic estimate of what a property will sell for and can be objectively determined.

Market value is defined in Section 12 of the Expropriation Act, as amended, as

"the amount which the property would have realized if sold on the date of notice in the open market by a willing seller to a willing buyer".

This definition is often hypothetical in nature as there is seldom an open market, willing buyer or willing seller, and properties expropriated are seldom sold on the particular date of notice; but it has universally been considered to provide the best guidance for objectively determining equitable compensation.

Another useful definition used in the United States¹ defines market value as:

"the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1 From the Federal Financial Reform, Recovery and Enforcement Act of 1989, quoted by Ryan, J.P. "Market value: A refocus", *The Appraisal Journal*. October 1992. Chicago: The Appraisal Institute. p 560

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1. buyer and seller are typically motivated;
2. both parties are well informed or well advised and each acting in what he considers his own best interest;
3. a reasonable time is allowed for exposure in the open market;
4. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale."

3.4 - the value of the owner's investment in it.....

This is a subjective value to a particular investor and is not market value, although it may be used as an input in arriving at market value. Investment value will depend on the owner's pre-determined desired rate of return, his assessment of risk, his tax obligations and other personal investment criteria.

The value of the owner's investment in a property could be the actual purchase price paid for the property, or more usually his equity portion, plus an anticipated return in relation to the risk involved. However, because of its subjectivity, there would seem to be no reason to prevent a court deeming say an 8% p.a. annual return on a block of rented residential townhouses purchased in 1949 to be "just and equitable", when they could easily be converted to individual sectional title ownership and be sold in the open market today at a price very much more than the court's deemed value of the owner's investment.

3.5 - the interests of those affected.

Under existing legislation holders of registered rights as well as all lessees of unregistered rights are entitled to compensation and there is no difficulty with this relevant factor.

4 Compensation payable in some other countries

- 4.1** In most countries the quantum of compensation is designed to be sufficient to restore the person whose property has been expropriated to the same position that he was in immediately prior to the expropriation notice, and to do so in an objective and equitable way, by applying the principle of substitution.

- 4.2 The first part of sub-section (2) is not dissimilar to the fifth amendment to the United States constitution, the relevant part of which reads:

"No person shall...be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation."²

"Just compensation is the payment of a fair market price for the property taken"³

- 4.3 In Britain, compulsory acquisition is also based on market value and the Land Compensation Act of 1961 contains a number of basic rules of valuation, similar to Section 12 in our Expropriation Act, as amended. The principal rule (2) in the British legislation reads:

"The value of land shall, subject as hereinafter provided, be taken to be the amount, which the land if sold in the open market by a willing seller, might be expected to realize."⁴

Besides payment of compensation for the actual taking, compensation is also payable in Britain for injurious affection, severance, disturbance and other ancillary costs such as conveyancing and interest.

- 4.4 In Malaysia and Singapore, article 13 of the Constitution states that:

"No person shall be deprived of property save in accordance with law, and
No law shall provide for the compulsory acquisition or use of property without adequate compensation."⁵

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- 2 Quoted in Heathcock, C.L. 1968. *The United States Constitution in Perspective*. Boston: Allyn and Bacon, Inc. p 198
- 3 Heathcock, C.L. 1968. p 202
- 4 Denyer-Green, B. 1989. *Compulsory purchase and Compensation*. Third edition. London: The Estates Gazette Limited. p 132
- 5 Tan, K, Yeo, T.M., and Lee, K.S. 1991. *Constitutional Law in Malaysia and Singapore*. Singapore-Kuala Lumpur: Malayan Law Journal Pte Ltd. p 674

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5 Compensation currently payable in South Africa

In South Africa, compensation payable to owners under the Expropriation Act, as amended, comprises -

- (1) an amount for market value and/or an amount for *actual financial loss caused by the expropriation*; plus
- (2) an amount for *solatium* calculated as a percentage of the amount determined in (1) above; plus
- (3) an amount for loss of interest, subject to certain provisions.

6 Concluding remarks

In the open, competitive market economies of our "global village", the estimation of market value (or the prediction of most probable selling price), forms the basis of most real estate decision-making, including the determination of compensation for the public taking of privately-owned property.

Market value has consistently proved to be a reliable norm for determining a real economic loss in cases of expropriation, and a comprehensive body of case law has developed over the years in South Africa and in other countries concerning the interpretation of "market value". Introducing additional subjective norms, which may result in numerous different interpretations and wide disparities in the payment of compensation, is bound to cause confusion and considerable dissatisfaction.

Yours faithfully,



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