

# Novelties on land value capture in Spain: the 8/2007 Land Act's new paradigm on land valuation.

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## **Abstract.**

The first comprehensive planning legislation in Spain, the “Town and Country Land Act” (TCLA), dates back to 1956. The main contribution of that legislation was to build the basis that supported the huge expansion of the Spanish cities in a context of economical recession and international autarchy. From the land appraisal perspective, the 1956 TCLA introduced an innovative paradigm that allowed the impoverished landowners to become effective urban developers, in a context where formal investors were scarce. Such an invention consisted in guaranteeing the proprietors the future betterment to be produced as a consequence of the urban development process, by means of the planning regime. As a consequence, for more than 50 years, by law, the land was appraised according to its future urban potential, without considering its actual, real, and present condition; with this system it was possible to mortgage the developments using the property rights of the original plots, assessed as serviced land, as guarantee. Spain is no longer what it was fifty years ago, and it is also reflected in the new planning regime; in this context, the 8/2007 Land Act, recently approved by the Congress, is one of the most important milestones on the Spanish planning implementation system. Two key changes stand out: first, the almost-exclusive right of land owners to promote the land development has been relaxed, and now other non-proprietors can start a development process on third party land; second, the land valuation invention of the 1956 TCLA has been completely wiped out, since the land is no longer appraised according to its future value, but only considering its actual and present condition. The model based in urban fiction has been transformed into another one based on urban realism. The new model is more oriented towards participation by the community in the surplus values accruing from development action by public bodies, and in this aspect this Act is more coherent with the correspondent 1978 Spanish Constitutional precept (section 47). In this paper I highlight the differences between the actual and previous valuation system, in order to try to foresee the probabilities of success of this reform as an effective land value capture system. Firstly, the land valuation paradigm introduced in 1956 is outlined; secondly, the new appraisal process introduced by the 8/2007 Land Act is presented; thirdly a comparative analysis of the value formation chain of both valuation systems is provided; and finally I discuss the probabilities of success of the new valuation

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system as an effective tool of land value capture based on some inconsistencies of the Law and on the public speeches of Regional Planning Authorities.

**Key words.** Public value capture, Spanish 8/2007 Land Act, Land Valuation.

## **The Urban fiction of the Town & Country Land Act 1956.**

It is well known that Spain, except for some of its regions, was one of the latest European countries to transform its economy in the industrial era. For that reason, the main urban growth the country-town migration occurred in the second half of the 20<sup>th</sup> century. For this reason the country did not have a real need for a Town and Country Land Act, until the middle of the last century. Nevertheless, there were several ailed Acts, such as the Leyes de Ensanche (urban expansion acts) and the Instrucciones Sanitarias (Urban Sanity Acts) and the Ordenanzas Municipales (Municipal Edicts) that guided the pre-industrial urban growth, especially in big cities that had effectively industrialized before 1950, such as Barcelona or Bilbao.

In 1956 Franco's government passed the Town & Country Land Act (T&CLA), an Act that was at the same time a Planning Act and a Land Act. This legislation established that the planning system, and specially the General Land Use Plan (Plan General de Ordenacion Urbana, -PG-), as the key instrument on the planning regime, and established landowners' rights and duties on both urban development and building. This new legislation was created in a context of crisis and recession left by the Civil War and the international isolation. At the same time it was a time of huge migrations from the rural interior and south of the country towards big cities and capitals, it was necessary to rapidly expand the urban fabrics to house such a population, nevertheless economic resources were scarce and real estate developers were inexistent. In this context, the law makers created a skilful invention: the virtual wealth. The 1956 T&CLA guaranteed to landowners the planning gains of the future urban transformations, by means of the planning system. That is to say, a valuation based on the future and uncertain urban expectative was imposed by law (that is to say, the market value of the building right minus the cost of land assembly), without considering the real and present land value. In these terms, land included inside the area classified as developable by the PG could be assessed according to its future urban use instead of its actual rural condition. The financial system agreed to finance the urban development taking the property rights as a guarantee. In that way the financial problem was solved, nevertheless the absence of urban developers still remained a problem. The Law also introduced another peculiarity of the Spanish planning regime. Since 1956 the land owners, without considering their entrepreneurial abilities neither their studies or aptitudes, have the duty to become in real estate developers and transform its rural land into urban land according to the PG (and other derived plans). According to Garcia-Bellido "farmers and landlords have become subsidiary entrepreneurs". The passing of the 1956 T&CLA allowed controlled urban growth, nevertheless with a high social cost: the private appropriation of all the planning gains. This circumstance made a perverse mechanism of planning gain compensation: if land situated inside of the area classified as developable was going to be expropriated, the payment to the owner (justiprecio) must include the public planning gains. This

was an absurdity, because the society was paying a value created by itself. The T&CLA was reformed in 1975 and together with its reform was recast in the 1976 T&CLA, this reform introduced a new land owner duty: the obligation to make a cession of 10% of the building volume to the public administration as a public capture of planning gain.

Fifty years separate the contemporary Spain reality from that of the middle of the past century. Between these two realities there is not only time, but also tremendous changes in economics, demographics, and politics. According to this new reality a new Land Act has born, the new 8/2007 Land Act has substituted the 6/1998 Land Act which was the substitute of the 1992 and 1990 T&CLA reforms, that substituted the 1976 and 1975 T&CLA, that replaced the original 1956 T&CLA.

In the present Spanish Planning Regime regional governments (Comunidades Autonomas CA) have the right to legislate in terms of urban and regional planning regulation. So there are as many Planning Legislations as there are CA. Nevertheless the 1978 Constitution reserves to central government the right to establish the property's basic rights and duties. In that way, the appraisal of land property rights, for certain purposes, is a national matter regulated by the Land Acts.

## **The 8/2007 Land Act's new paradigm on land valuation.**

The new 8/2007 Land Act has introduced some changes oriented to capture more public planning gains. For example, the percentage of urban potential cession has increased from 10% until 15%, and in some cases, when the gaining is considerable according to the location of the plot or the kind of use and typology, this cession can be up to 20%. For this reason this legislation is more coherent with article 47.2 of the Spanish constitution which enables the public participation on planning and other public gains. So it can be said, that land value capture has been doubled. Nevertheless in this paper I will discuss a more relevant change: the new paradigm of land appraisal for certain purposes.

The new Act, on the contrary of the past Land and Planning Legislations (excluding the 1990/92 Land Act), states that real estate included in areas classified both as urban and developable must be appraised according to their present condition, without considering the future urban development (or redevelopments). In the past a rural plot, classified as developable, was appraised according to the future building volume assigned by the PG (and specified by detailed planning) discounting the cost of infrastructure provision, nevertheless the plot were used for agriculture and development would no were to take place for a many years. Therefore, for first time in the Spanish Planning Regime the land is appraised with out considering the uncertain future, even that in terms of land use and building volume it is guaranteed by planning.

The new change introduced by this legislation is not only an issue of social justice; it is also a matter of common sense. This is the key change of the Law, in its preface it is say that:

“Since 1956 Act, the land legislation has established, in a continue way, a special regime of real estate valuations that replace the general criteria of the Compulsory Expropriation Act of 1954. It has been done, using a common approach: to assess the land according to its urban classification, that is to say, according to its destination and not to its real situation. With this

procedure, sometimes the legislation has tried to approximate the resulting value to the market value, assuming that in the land market there are no failures and speculative interests to be penalised by public administrations according to the Constitution. As a result of this, a paradox emerged because the real value was not based on real estate's reality, but on the expectations generated by planning processes generated by the public powers".

Furthermore, the old valuation systems based on the valuation on urban expectations was contrary to some precepts of the Compulsory Expropriation Act of 1954, concretely section 36, which establish that "real estate valuations [to determinate the compensation] will be carried out without consideration of the gains produced as a consequence of the plan or urban project that legitimise the expropriation or the expectable future gains". The special land valuation regime, was founded exactly on the contrary, that is to say, to paying a value of something, still, non existing.

This new paradigm in Spain is no novelty in any of its geographical context, since existing value is a common practice everywhere in Europe. From now on, rural land, even if it is included in a developable area, is appraised according to its rural nature. Also, urban land included in an urban renewal area is assessed according to the original plan without considering the future use in the new plan.

## Application of the Act's and Appraisal Criteria

According to Section 20, the Land Act's appraisal criteria are only applied in the following cases:

1. When the Joint Development Organization (*junta de compensacion*) does not have a particular agreement about the appraisal of development benefits.
2. To calculate the payment to compensate landowners in cases of property expropriation.
3. To calculate the payment to compensate landowners in cases of compulsory purchase.
4. To calculate the patrimonial responsibility of the public administration.

Therefore, only in the cases where the urban development is carried out using the expropriation system (the public administration expropriates the land and pays the provision of public infrastructures) or there is a compulsory purchase (a public or private land developer acquires the land and pays the provision of public infrastructures) there is the possibility to capture the planning gains since the price paid as a compensation or as a price does not include the future gains derived from the implementation of the new planning.

## Appraisal criteria for rural land

In the last Act (6/1998) the valuation method used in the case of rural land was the direct comparison with the market. In this approach the expectations are considered only if the observed price markets consider these speculative values. Nevertheless in this new law the land value is calculated actualising

the real potential rural rents. As a matter of fact, if land does not have rents, the legislation permits considering potential rents, and if the potential rents are higher than the actual rents, it is possible to use the higher ones. Also, the Act allows for the duplication of the value obtained according to the above estimation in the case of plots well situated or with outstanding natural amenities. Let's suppose that the actual land value of a plot, considering the best of its rural rents, is 10 Euros for each square meter, if this plot is situated near a city of an economic pole, or if it has excellent natural features, so the new legislation allows to multiply its value up to 2.0 times. As it is evident, the Law has renounced to use the market value, but the net actual value is also the market value (not considering the speculative urban future), that is to say, this is the value that an investor may pay for acquiring a plot given a return rate and considering market rural rents. Nevertheless the former affirmation is only true if the discount rate is the market return rate, that is to say, the rate that considers the risk assumed in this investment. So if both the discount rate and the rents are market information the resulting capitalisation value is also a market value. Nevertheless it is not the case, because the Act, "accidentally", does not consider market rates on the actualisation of rural rents, but "legal" rates. Concretely, the rates are those derived from Treasury Bonds, so the Act assumes that investment in rural land has the same risk that the safest investment that could be made in a western country; it is to say, the risk in acquiring rural land for its use is exactly the same as that of the purchase of public treasury bonds. This catastrophic incident derives in a paradox: the result of the rent actualisation is not the existing value but another value, that can be superior to the actual value if what is considered is poor land, or minor if what is appraised is highly agriculture productive land!. Furthermore, the law has another "accident" in the valuation of this category of land. Due to the fact that any land surveyor understands that rural rents consider the accessibility and natural externalities, it becomes unnecessary to consider these factors a part, as established by the Act. In the case of agricultural rents, the improvement in accessibility means a reduction on transportation costs, and other production costs, so an increase in potential rents; in other rural rents, like those derived from country hotels and camping installations an improvement in the natural externalities implies an increase in potential rents. So market rents include both accessibility and externalities, and for this reason it is not necessary to count them again. *If the actualised value is increased up to 100% the resulting final value is another one, but not the existing value.* Maybe this mechanism is only the façade of an extra compensation given to land owners of plots situated in very accessible areas.

### **Appraisal criteria for urban land.**

According to the 8/2007 Land Act, urban land may be in one of the following situations: 1) vacant land, 2) constructed land, and 3) urban renewal land. The vacant land is the land without edification, or the land with a ruined or illegal construction. The constructed land is the land that has been legally constructed or the land that is being constructed

The vacant land is valued according to its residual value. The residual value of land is calculated considering the value of the finished real estate and discounting the productions costs associated to the real estate development (benefits included).

The constructed land is valued using the highest value considering: a) the direct market value; and b) the residual land value (as if the plot were vacant). The main problem of this method is to assess a real estate in process of edification. This problem becomes relevant when what is valued is a plot with an

old structure whose building process was interrupted a lot time ago, and now is not fully appreciated in the market.

## **Critics and successful probabilities.**

As I have mentioned above the appraisal criteria for rural land (developable and non developable) has serious conceptual problems, since there are no full economic principles behind Act's criteria. As a consequence the resulting price is not a market price of rural land but another "legal" and artificial price. It is uneven that landowners will be willing to accept a price that can be inferior to the real market value of their agricultural land. It is important to note that such situations may occur when what is appraised is excellent, productive and fertile land. In this context what is foreseeable to expect is a great debate in courts when negotiating the expropriation price. In Spain, the Compulsory Expropriation Act (Ley de Expropiación Forzosa) allows to negotiate the value of the compensation price paid to expropriated landowners.

Nevertheless the main aspect to challenge is the possible unconstitutionality of the entire Act's Appraisal Title. 1978 Spanish Constitution guarantees the same level of rights and duties for all Spaniards, including the rights related to property and other real rights. However section 26 allows to use the anterior appraisal paradigm when what is appraised are the property rights of land included in an Land Reajustment Areas (Ambitos reparcelatorios). That is to say, if the land development instrument (determined in the Plan) is expropriation, the economic value of property rights does not include planning gains, nevertheless if the chosen instrument is a private Land Readjustment Area almost all the betterment (up to 80%) is included in the economic value of property rights. *This is an unequal treatment of Spaniards and for this reason this Title may be understood as unconstitutional.* As a matter of fact this is the main complaint of the Spanish Real Estate Development Associations, that could, in the near future, be treated in the Constitutional Court.

As is evident, in order to capture the planning gains it is necessary that the Planning Authority declare, in the planning process, that expropriation is the land development instrument. In such cases, almost all the betterment is captured by the public administration. Furthermore, from the public finance perspective such expropriations may be feasible since the expropriation price would not include betterments. Nevertheless in the past expropriation, although when the compensation price included the future planning gains, was not a popular instrument, and mainly for this reason was not extensively applied. The political cost may be important when the Planning Authority, with competence to declare the land development instrument, is the City Council, especially when municipalities are small and poorly inhabited as in many Spanish boroughs, where there are more than 8,000 Planning Authorities. For that reason, it is highly probable that in the future expropriation will become in an extremely unpopular instrument, which may reduce the willingness to use it by local administrations as a land development instrument.

## Conclusions.

Public participation of planning gains is in Spain a Constitutional precept. In this context the new 8/2007 Land Act opens possibilities to increase the betterment capture. On the one hand, the cession of building rights has increased from 10% to 20% of the total building volume; on the other hand, when the Land Uses Plans (General or detailed) declare that the instrument to develop the land is expropriation almost all the betterment is captured by public bodies, since the compensatory price does not include future planning gains.

For the first time, since the 1956 Town and Country Land Act, the economic value of property rights does not include future planning gains. The land is appraised according to its actual, real and present condition, without considering the future possible transformations. Rural land is appraised according to rural rents, and urban land according to its market urban value. Nevertheless the lack of fully economic principles behind the appraisal criteria for rural land may complicate the appraisal process, and increase the number of cases solved in courts.

Finally, the unpopularity of expropriation as a land development instrument may increase since the *justiprecio* (fair price) will not include betterments, and for that reason this may reduce the local administrations' willingness to use it as a land development instrument, reducing the real possibilities of public bodies to capture planning gains.

## Some further references.

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