

# Land of Make-Believe: Compensating landowners for what might have been

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Daniel Bentley

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## Summary

A cornerstone of the planning system is that if permission to develop is refused then the landowner is not entitled to compensation for the potential value that has been lost. Without this no-compensation rule, introduced under the 1947 Town and Country Planning Act, the planning powers of local authorities would be inoperable due to the vast liabilities they would incur towards landowners whose schemes were refused. There is, however, an exception to this rule. Under the land compensation code governing compulsory purchases, landowners *are* entitled to potential development values arising from planning consents that may have been granted had the public authority not determined that the land should be put to a different use. This incongruity is a hangover from the 1959 Town and Country Planning Act which, after a 12-year period during which the public sector could acquire land at existing use value, returned compensation awards to 'market value'. But in cases of compulsory purchase, market value had always been a somewhat artificial concept, circumscribed by statutory definitions which changed over time.

The 1959 Act enshrined the Pointe Gourde rules that would govern compensation awards henceforth and determined that landowners were to be compensated for the value of their land in the absence of the scheme. These 'no-scheme world' arrangements meant that the valuation would not incorporate any increase in value owing to the infrastructure planned under the scheme. But, as set out in the legislation, they also granted landowners entitlement to compensation for the loss of a prospective planning permission that was now impossible to realise. This last gave statutory recognition to the concept of 'hope value' – value arising from the hope that land would receive a different planning designation at a future point. But this was at odds with the continuance of the no-compensation rule for planning permission denied, which by 1959 was widely accepted and regarded as integral to the functioning of the planning system.

The discrepancy created a dilemma for public planning. While planning authorities were able to determine what development could *not* take place without incurring liabilities, they were not able to determine what development *should* and *would* take place on the same terms, if the landowner had a realistic hope of pursuing alternative development prior to the initiation of the public-sector scheme. As the differential between agricultural and residential land values grew rapidly over the following decades, this position created a financial obstacle to proactive strategic development of the kind that was undertaken in the decades immediately following the Second World War, most notably in the new towns programme of that period.

## Early planning and the compensation problem

England's planning system evolved piecemeal in the early 20th century. Following on from the basic public health legislation of the late 19th century, the conception of the planned use of land was first put on a statutory footing by the 1909 Housing and Town Planning Act. This was followed by the 1919 Housing and Town Planning Act, the 1925 Town Planning Act, the 1929 Local Government Act, and then the 1932 Town and Country Planning Act. This body of legislation was built on the principle that development decisions were not a matter to be left in the sole charge of those with the title to the land, and it laid the groundwork for a democratically-accountable system of land-use designation. Yet it was not until after the Second World War that England could really be said to have a planning system in much more than name. The town and country planning legislation of the early 20th century remained largely ineffectual until the 1947 Town and Country Planning Act and the radical new land values policy it ushered in.

The biggest obstacle to effective planning until that point had been the onerous nature of the compensation arrangements in place for landowners affected by local authority development plans. Where the authority forbade development that the landowner wished to undertake, the council was liable to pay compensation for the potential increase in value that had been lost. This had been a feature of the planning legislation starting with the 1909 Act, which gave a general right to landowners to claim compensation where their property was injuriously affected by the making of a town planning scheme. There were exemptions to this; the 1932 Act stated, for instance, that the refusal of 'un-neighbourly' prospective development - such as turning a house into a workshop in a residential street - should not necessitate the payment of compensation. Nevertheless, liabilities remained such that the introduction of binding development plans were by and large deterred, as local authorities dared not incur liabilities they had no means to settle. By 1942, still only 5 per cent of the acreage of England was covered by an operative land use plan (Uthwatt, 1942).

This issue became of acute public and political concern during the 1930s as local authorities felt powerless to prevent ribbon development, urban sprawl and the loss of open space, or to rectify the slum and over-crowded housing that remained from the rapid industrial development of the previous century. The Barlow Commission on the Distribution of the Industrial Population, which reported in 1940, painted a picture of inner-city housing that was densely packed in close proximity to the pollution of factories and with no allowance made for amenity and recreation; meanwhile development on the outskirts of towns and cities was proceeding faster than community facilities could be installed, was leading to ever greater traffic congestion and was pushing the countryside further and further away from the centre:

In short there was no town planning; it is in the unplanned areas of badly constructed and congested housing that the health records of the great cities and conurbations are worst. (Barlow, 1940)

The failure of planning, it said, was due to the difficulties arising from the system of compensation and, its twin, betterment - the increase in value that followed from a planning permission granted. These were 'so great as seriously to hamper the progress of planning throughout the country'.

Subsequent to the Barlow report, an in-depth examination of the problem of compensation was commissioned in January 1941. That ministers were concerning themselves with this as

the Blitz still raged is an indication of the importance they attached to this issue as part of the eventual reconstruction. The Expert Committee on Compensation and Betterment, chaired by Mr Justice Uthwatt and reporting in September 1942, described a situation in which development proceeded in much the same way that it would have done *sans* planning. Town planning schemes largely reinforced the uses to which landowners wanted to put them, whether that was in the public interest or not:

Unquestionably the greatest obstacle to really effective planning has been the fear on the part of the planning authorities of incurring indefinite liabilities in the matter of compensation if the extreme step of forbidding development is taken. ... An examination of the Town Planning maps of some of our most important built-up areas reveals that in many cases they are little more than photographs of existing users and existing lay-outs, which, to avoid the necessity of paying compensation, become perpetuated by incorporation in a statutory scheme irrespective of their suitability or desirability... (Uthwatt, 1942)

After several more years of debate, the 1947 Town and Country Planning Act started from the same premise and sought to deal with the compensation question once and for all. The town and country planning minister, Lewis Silkin, reiterated the Uthwatt critique during second reading in the House of Commons:

The relative failure of town planning hitherto can be attributed to a number of causes, but the principal one is, undoubtedly, the obligation on local planning authorities to pay compensation to an owner of land who, in the public interest, is refused permission to develop. On account of this obligation, which in the case of smaller or poorer authorities may constitute a burden entirely beyond their resources, local authorities have been unable to prevent undesirable development, and land which should have remained unbuilt on, and reserved for agriculture, or open space, or playing fields, has been lost to the community for ever. (Hansard, 1947)

### **The 1947 Act and the no-compensation rule**

The 1947 Act was significant for various reasons. For the first time it placed an obligation on councils, rather than simply permitting them, to survey needs and draw up development plans. It allowed them to designate land in that plan as subject to compulsory purchase, in order to ensure it was implementable. It gave local authorities the power to carry out compulsory purchases, if they needed to, at existing use value (albeit with some compensation for the owners of land ripe for development in 1947). And it introduced a development charge on private builders that taxed planning gain at 100 per cent. But the biggest leap forward it made by far - the one that finally made town and country planning a reality, stood the test of time and undergirds the planning system to this day - was in establishing that landowners denied permission to develop would not be compensated for their potential, but unrealised, profit.

For the first time, not only could the local authority determine that a planning development could not go ahead, it would also face no liability to the landowner for the values that had been denied. Mindful of the transitional losses this was likely to cause those in possession of land ripe for development in 1947, the government set up a fund capped at £300 million on which landowners could make claims. Although this would become known as a compensation fund, Silkin stressed that this was not compensation in the strictest sense: payments were to be made in recognition of hardship caused by the change in policy, not

because landowners had a right to expect to be reimbursed for their losses.<sup>1</sup> This sentiment reflected a new political outlook on the rights of landowners, and in particular a reconsideration of their entitlements to increases in land values, that had been evolving for a century or more.

In many respects the 1947 Act was the high-water mark of the land reform movement that had been gathering momentum since the later decades of the 19th century, inspired by classical economists such as John Stuart Mill and Henry George. A land value tax on site values had been attempted twice and abandoned twice by this stage. But the idea that betterment, or planning gain, should be taxed or captured by the state was underpinned by precisely the same reasoning: that land increments were the product of the community and so should return to the community.

The no-compensation principle for planning permission denied represented a sweeping extension of the much more limited compensation exemptions that had featured in the earlier legislation. It was an extension that had been advocated by the Uthwatt Committee, which asserted that the ownership of land did not confer unqualified rights as to its use, nor therefore to compensation if those rights were restricted in the public interest:

The question is whether any kind of restriction at all imposed in the public interest on the use of land by private owners should carry a right to compensation. The mere regulation of the use of land in the interests of the community would not, if the common law were followed out, involve any such payment, and an owner could, therefore, consistently with the common law, be required to refrain from using his land for purposes specified by the State. Obedience to such a direction would not entitle him to compensation.

For all of the controversy that surrounded the financial provisions of the 1947 Act over the following decade or so, the no-compensation rule drew comparatively little attention and was soon taken for granted as a feature of the planning system. What was not taken for granted were the betterment provisions – the development charge and the power to compulsorily purchase at existing use value – which were the twin of this no-compensation policy. Taken as a package there was a logical consistency between these measures: landowners were not to be compensated if planning permission was denied, nor were they to gain if planning permission was granted. Development rights had been vested in the state – nationalised, in the spirit of the times – and with them so had the values that those rights generated.

### **The abolition of the development charge and the two-price system**

But resistance was fierce and over the following years the betterment provisions would be gradually dismantled. The first to go was the development charge in November 1952, blamed for disincentivising the private development to which Harold Macmillan, then housing minister, was looking in his pursuit of 300,000 new homes a year.<sup>2</sup> This was first and foremost a pragmatic choice to aid the new Conservative government's housebuilding objectives, not – for Macmillan at least – a renunciation of the principles embodied in the

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<sup>1</sup> Silkin: 'A sum of £300 million is to be provided out of which payments will be made to meet cases of hardship, where land will be depreciated in value. although I will hereafter in my speech, for the sake of brevity, refer to them as compensation, I do not thereby mean to use the term in the ordinarily accepted sense.' (Hansard, 1947)

<sup>2</sup> The charge was abolished under the 1953 Town and Country Planning Act but the Central Land Board ceased levying it as soon as the Bill was introduced in November 1952.

1947 Act. This is why, remarkably, the abolition of the development charge was not accompanied by the removal of local authorities' power to purchase land at existing use value. Nor was it accompanied by the restoration of compensation for landowners denied planning permission; on this, in fact, Macmillan went further. Little more than six months before the £300m fund was due to be paid out (in summer 1953) to offset losses from values extinguished in 1947, Macmillan decided that these payments would not be made across the board. Instead they would only be paid where a planning permission had been submitted and refused, or where land had been compulsorily-purchased. This new 'pay as you go' system, he calculated, would reduce the government's liabilities to in the region of £100m; by 1954 they were thought to be even lower, at about £50-60m (Hansard, 1954).

Macmillan was unapologetic about his continuation of the no-compensation rule. He reaffirmed the classical economists' view of land values, stating that 'these values will have been created by the efforts of the community', and he pointed out the very great practical difficulties of returning to compensation for planning permissions denied. His 'overwhelming' concern, he said, was to avoid the costs that had previously prevented the effective functioning of the planning system prior to 1947:

If compensation had to be paid in future on values as they accrued, unknown and perhaps heavy claims would fall upon the community. Thus the broad principle of the 1947 settlement—no compensation for values which accrue after 1947—has been generally accepted as fair. (Hansard, 1952)

But the 1953 Act, under which the development charge was abolished, created an anomaly: while the no-compensation principles remained intact for the refusal of permission and for land purchased by local authorities, where landowners sold to private builders they were able to collect the increase in value arising from its new residential use. This became known as the two-price system and was the source of a rising sense of injustice among those landowners whose land continued to be purchased by the state at existing use value (plus any 1947 value) over the following years.

Ministers were well aware that the two-price system would be the result of the changes but felt it was justifiable for practical reasons: the theoretical case for no-compensation remained, but pragmatism dictated that private builders would have to be exempt from the development charge. Within several years however – and with Macmillan now prime minister – the government had done a complete about-face and felt that local authority acquisitions at existing use value would have to be abolished too. The housing minister Reginald Bevins described the difficulty:

The two-price system has not only come to be regarded as an injustice associated with so-called land grabs and the use of the big stick by authority against the citizen. It has also tended to hinder local authorities in selecting the best sites for their purposes. Some of the local authorities have not been prepared to cause injustice; or, for that matter, to incur the odium which comes from the present basis of compensation for compulsory acquisition. (Hansard, 1958)

### **The 1959 Act and the return to 'market values' for compulsory purchases**

The government's response to this situation came in the 1959 Town and Country Planning Act, which removed the right of local authorities to acquire residential land at existing use value. This meant returning compensation for compulsorily-purchased land to market value.

The changes in the 1959 Act were all to do with fairness between different landowners and little to do with fairness between landowners and the community. There was no repudiation of the principles that had underpinned the 1947 settlement and which Macmillan had restated at the time of the 1953 Act. The abandonment then of the development charge had been for practical reasons; and when landowners faced with public acquisition subsequently complained that they were, *de facto*, still subject to this charge, ministers gave in.

But while the differential in prices paid for land between the private and public sectors had now been dealt with, other anomalies remained. The biggest and most obvious inconsistency centred around the difference in treatment between landowners who were granted planning permission – who would now be able to capture all of the uplift, with no betterment tax at all – and those who were not. Compensation levels for landowners refused permission did not change, which is to say that they were not to be compensated except for any value that had been in the land at the time of the 1947 Act – now 12 years previous.

The reason for this was once again pragmatic, based on the fact that resistance to this principle had not been so fierce – and that, in the words of the lord chancellor, Viscount Kilmuir, ‘to change the basis of compensation for planning refusals now would be to destroy planning as we have known it since the war’. (Hansard, 1959) Bevin acknowledged that this was a ‘fairly workmanlike’ response to the situation but added:

Nowadays, the country accepts planning restrictions as one of the necessary facts of life. It is certainly a fact that planning refusals have not given rise to that same sense of grievance as that which comes from compulsory purchase. (Hansard, 1958)

That there was now a new two-price system in place, one in which development values would accrue to those landowners with planning permission but not to those denied it, does not seem to have been a major consideration, despite earlier efforts to ensure there was consistency across both sides of the compensation and betterment question. But the significance of this was not lost on Silkin who had watched his 1947 legislation emasculated over the following 12 years:

The decision as between two pieces of land is purely arbitrary. It is just a matter of luck whether one particular owner will be allowed to do a particular thing, in which case his compensation will be higher, while another owner will be allowed to do something quite different, whereby his compensation will be less. The amount of compensation does not depend on the intrinsic merit of the land, its intrinsic value or even its position. It is a matter of pure luck whether one owner gets high compensation and another gets low compensation; and there is nothing in this Bill which removes that anomaly. On the contrary, this Bill increases it. (Hansard, 1959)

The question left hanging was, if the government was concerned that different landowners had been paid different sums according to whether their land was being purchased by the public or private sectors, why was there no corresponding concern for the different sums landowners received according to whether they received planning permission or not. This ‘winner takes all’ approach was especially perverse given that the windfalls that would accrue to a minority of landowners owing to the granting of planning permission were enhanced due to the denial of planning permission to others.

### Pointe Gourde and the introduction of 'hope value'

Further complications were contained in the details of the compensation provisions. While the 1959 Act was described as marking a return to 'market values', the reality was not so simple. Compensation following compulsory purchase was not to be based on the market value of the land in the real world, taking into account the development that was planned under the scheme for which the acquisition was being made. Quite the reverse: it was to be based on the market value of the land *in the absence of the scheme*. This was the 'no-scheme world', or Pointe Gourde rule, which meant that compensation was based not on the true value of the land in the actually-proceeding course of events but the value of that land in an imaginary parallel timeline. The precise application of this rule, to arrive at the assumed 'market value', involved making a series of assumptions which had been continually contested and amended through more than a century of legislation (notably the 1845 Land Clauses Consolidation Act and the 1919 Acquisition of Land (Assessment of Compensation) Act) and case law (latterly the Indian Case of 1939 and the Pointe Gourde case of 1947). In cases of compulsory purchase, market value had always been an artificial concept, circumscribed by the compensation rules that applied at the time.

The 1959 Act picked up these rules from where they had been left, by and large, prior to the 1947 Act. By this point, of course, any assessment of market values had to consider the planning designation of the land in a way that it never had before 1947, and so it was felt that the no-scheme world rules now had to reflect that too. As laid down in the 1959 Act, assumptions regarding planning permissions included that: the land would have received permission for the purpose for which the compulsory purchase was being undertaken; the land would have received permission for the use to which it had been allocated in a development plan; and, in places where this might not be clear, the local authority would be able to issue a certificate saying what planning permission might reasonably have been expected in the absence of the scheme (Law Commission, 2002).

This statutory recognition for prospective planning permissions (in addition to any planning consent already obtained) was an extraordinary concession for the government to make. In direct contradiction to the no-compensation rule, which by this stage was firmly embedded as a cornerstone of the planning system and which ministers continued to defend, landowners could now be compensated for planning permissions that would never materialise. The provisions were consolidated two years later in the 1961 Land Compensation Act: Section 5 stated that the value of the land should be 'taken to be the amount which the land if sold in the open market by a willing seller might be expected to realise'; Sections 14 to 17 went on to describe the assumptions that may be made regarding prospective planning consents and alternative development. This became the statutory foundation for the payment of 'hope value': the value attached to the hope of a prospective future planning permission. This notwithstanding the fact that a compulsory purchase would only ever be undertaken to advance planning objectives which excluded the possibility of that permission ever being granted.

Some of the consequences of this might not have been apparent in 1959 or 1961. It is clear from the parliamentary debates in 1959 that ministers expected the legislation principally to affect prices paid on the edges of towns and cities, where development values had risen considerably since 1947 and where, since the repeal of the development charge in 1952, the

sense of injustice among landowners subject to local authority acquisition was most acute. Even there, however, the development value at that time was said to be only three or four times as much as the existing use value, nothing like the multiples of 100-times plus that have been seen in recent decades. Viscount Kilmuir assured the Lords that the issue the 1959 Act addressed was 'not a great grievance, generally speaking, either in the middle of towns or deep in the countryside, because in those places there is not a substantial difference between compulsory purchase price and market value' (Hansard, 1959).

### **Denning: 'Conjure up a land of make-believe'**

From the perspective of 1959 or 1961 then, this change had little bearing on the development of new towns, given that they were usually some distance from substantial existing settlements. After all, the no-scheme world provisions disregarded the enhanced value arising from the scheme itself: with no hope value to consider in such places, land for new towns might still be purchased at existing use value. But, as over the years more and more locations began to be identified as potential housing land, so designations for new towns began to overlap with such sites. Land designated for new towns became vulnerable to challenges from landowners for hope value on the basis that it could have received a planning consent for housing even without the new town.

This issue came to national prominence with the Myers case in 1974. This focused on the compensation to be paid for just a small section (318 acres) of the 20,000 acres that had been compulsorily acquired in 1970 by the development corporation behind the construction of Milton Keynes. The owner of these 318 acres, Bernard Myers, was awarded £230,700, equivalent to just over twice the land's agricultural use value. Myers challenged this compensation award on the basis that it might – in the absence of the Milton Keynes scheme – have been used for housing development. He claimed for £636,070 - a sum roughly equivalent to 20 per cent of the land's residential use value (not the full residential value, as development was not certain and in any case not likely to take place for about a decade).

His claim was upheld at the Court of Appeal. In a famous judgment the then master of the rolls Lord Denning described the law thus:

In assessing the value, it is important to consider what would have happened if there had been no scheme ... The valuer must cast aside his knowledge of what has in fact happened ... due to the scheme. He must ignore the developments which will in all probability take place in the future ... owing to the scheme. Instead, he must let his imagination take flight to the clouds. He must conjure up a land of make-believe, where there has not been, nor will be, a brave new town, but where there is to be supposed the old order of things continuing... (Times, 1974)

This recourse to the 'land of make-believe' – to a parallel universe in which the planning decisions which have been made were something else – meant that landowners could win compensation for values attached to a planning permission which would never be granted. This scrambled the ability of development corporations to purchase land at or close to agricultural values, which had underpinned their business model all along. The sums involved in the Myers case in the early 1970s were not especially large, but the differential between agricultural values and residential values widened enormously over the years



ahead. Inflation in land values was rapid after the 'price watershed' of 1959 (Merrett, 1979), at which point residential land was worth perhaps five or six times as much as agricultural, depending on the location. By 1969 this multiple had already increased to something like 35; by 2015 this would be in the region of 100, on average, (Bentley and Aubrey, 2018) and very much bigger still in expensive parts of the South East. If the hope value was only a fraction of this, nevertheless the liabilities that could be incurred by public authorities were now of a different magnitude to anything that could have been dreamt of in 1959.

### **The legacy of the 1959 settlement**

The legacy of the 1959 Act was a multi-layered approach to land values. Those denied planning permission were entitled to no compensation, irrespective of the development potential in the land. Those granted planning permission were free to keep all of the uplift in value. Those whose land was compulsorily-purchased to facilitate a publicly-led scheme were to receive a 'market value' but a market value that disregarded the scheme for which the acquisition was being made and included potential planning gain that was now being denied.

The inconsistencies did not stop there. Over the following decades a series of attempts to recoup betterment culminated in the evolution during the 1980s of what would become the Section 106 system. Under this, contributions out of the uplift in land values are agreed on a case by case basis, at levels that vary considerably through time and depending on location, the type of development and ultimately the bargaining positions of local authorities and landowners respectively. Estimates of planning gain captured in recent years via Section 106 and the Community Infrastructure Levy have ranged from as little as, on average, 25 per cent to considerably higher than 50 per cent in particular cases (HCLG Committee, 2018). This meant that there was no longer even any consistency in the rate at which betterment was captured between any two developments. The logical symmetry of the 1947 settlement, replaced by a two-price system five years later, gave way ultimately to a patchwork multi-price system in which landowners would negotiate their offerings one site at a time – their bargaining power always underwritten by their real option to delay development indefinitely. Considerations of fairness to the community were secondary to an unwillingness to challenge the monopoly position of landowners.

The anomaly with the greatest consequence for planning featured in the rules governing compensation for planning permission denied. That compensation was not paid for the refusal of a planning permission was integral to the functioning of England's discretionary system, and virtually uncontested (Cullingworth and Nadin, 2006); when land was to be compulsorily-purchased to facilitate an alternative public-sector scheme, however, the expectation of a future planning permission was built into the compensation award. This last was consistent with the concept of the no-scheme world, with landowners compensated for the value of their land in a parallel timeline in which there was no scheme. But this failed to reflect the fact that by planning and initiating its own scheme, the public authority was in actuality refusing the planning consent that might otherwise have been sought. In the real world, a compulsory purchase would only ever be undertaken following a determination on

the land use which was at variance with the 'hope' of the landowner. The compulsory purchase was proof in itself that a planning permission would not be granted.

The appeal of the no-scheme world to policymakers lay – and lies still today – in the fact that it allows public authorities to disregard from compensation awards any value arising from the scheme itself. So if a new settlement is to be developed with new train stations and schools, and land in the area is compulsorily-purchased to enable this, then the additional value owing to that infrastructure would be excluded. However, by including in the no-scheme-world assumptions the prospect of a planning permission that would now be denied, the 1959 Act introduced a loophole in the no-compensation rule that underpinned the planning system.

The principal obstacle to effective planning had been removed insofar as local authorities were able to refuse planning applications from landowners and developers without fear of incurring significant liabilities. That fear remained, however, where a local authority or development corporation wished to undertake proactive, strategic planning of its own. It could determine what development could *not* be undertaken but it could not – on the same terms – determine what development *should* and *would* be undertaken.

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## Author

Daniel Bentley is editorial director at Civitas, where he has worked since 2013. Prior to that he was political correspondent at the Press Association. His previous publications include *The Land Question: Fixing the dysfunction at the root of the housing crisis* (2017), 'Reform of the land compensation rules: How much could it save on the cost of a public-sector housebuilding programme?' (2018), 'Building Homes Faster? A commentary on the government's plans for increasing the pace of development' (2017), 'The Future of Private Renting: Shaping a fairer market for tenants and taxpayers' (2015), and 'Finding Shelter: Overseas investment in the UK housing market' (with David Green, 2014).

He can be emailed at [daniel.bentley@civitas.org.uk](mailto:daniel.bentley@civitas.org.uk) and tweets [@danielbentley](https://twitter.com/danielbentley).

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55 Tufton Street, London SW1P 3QL

T: 020 7799 6677

E: [info@civitas.org.uk](mailto:info@civitas.org.uk)

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