

19 February 2019

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Dear Mr Vukela

### **Public Submission: Draft Expropriation Bill, 2019, No 42127, of 21 December 2018**

The Banking Association South Africa ("The Banking Association") would like to thank The Department of Public Works and the National Assembly Committee on Public Works for the opportunity to comment on the above-mentioned Bill.

#### **Who we are**

The Banking Association South Africa (The Banking Association) is an industry body representing all banks registered and operating in South Africa. Currently, The Banking Association has 33-member banks which include both South African and International banks. All licenced banks are members of The Banking Association. Our vision and role, together with our areas of focus, including a list of our members may be found on our website, [www.banking.org.za](http://www.banking.org.za)

#### **Context**

The Banking Association supports Government's initiative to address past imbalances through processes such as land reform, as envisaged and provided for by the Expropriation Bill.

The banking sector is a critical stakeholder because of the substantial sums of credit extended by banks in respect of "property". Banks have approximately R1.6-trillion in mortgage exposure to immoveable property, including agricultural, commercial, industrial and residential mortgages.

## Comments

We suggest four critical themes needed for the Bill:

- Alignment to the Constitution of the Republic of South Africa, South African case law and international norms;
- Completeness of definitions;
- Protection of the rights of owners and holders of registered and unregistered rights (notification, processes etc.to support this);
- The “just and equitable” principle as contained within Section 25 of the Constitution of the Republic of South Africa, 1996 to provide underpinning support for owners and holders of rights.

Our comments will thus be made considering these four themes.

## Chapter 1 – Definitions and Application of ACT

### Expropriation:

We submit that the definition for expropriation is incomplete as it does not include key aspects of sections 25 (3) and (4) of the Constitution (public interest, public purpose and just and equitable compensation).

We highlight that South African case law in respect of expropriation does not fully align to international norms, as the Constitutional Court interpreted deprivation as not constituting expropriation in instances where the State does not acquire the property. The Organisation for Economic Co-operation and Development (OECD) which consists of 36-member countries, including our biggest trading partners in Europe, The United States of America and Canada, amongst others, hold the view that expropriation or “wealth deprivation” could take various forms. This could be direct or “dispossession”, “taking”, “deprivation” or “privation” as constituting expropriation. Even in instances where a property is not seized or the legal title is not affected, but the state restricts use or the enjoyment of the benefits, it is classified by the OECD as expropriation, as the measures taken by the state have a similar effect to expropriation or nationalisation (they are termed “indirect” or “creeping” expropriation). This could pose a threat to South Africa being able to attract international investment if it were to effect the principle of deprivation not being tantamount to expropriation given that the Protection of Personal Investment Act (2018) subjected international investors to the confines of local legislation and hence removed their right of recourse to the International Arbitrating Court, if they are not satisfied with the fairness of compensation levels.

### Recommendation

The definition of expropriation must be aligned with the requirements of Section 25 of the Constitution. In this regard, we propose that the definition be amended to read as follows:

“Means any compulsory acquisition of property, for a public purpose or in the public interest and subject to just an equitable compensation, by an expropriation authority, and ‘expropriate’ has a corresponding meaning. In the case of expropriation of land by an expropriation authority, it may be just and equitable for nil compensation to be payable as per the provisions of this Act”.

### Expropriated holder

We submit that the definition of an “expropriated holder” is incomplete as it is only used to reference holders of unregistered rights in property (excludes holders of registered rights in property).

### **Recommendation**

We suggest that the definition for “expropriated holder” be amended to read: “Means a holder of a registered or an unregistered right in property, which right has been expropriated by notice in terms of section 8(1) or in terms of section 9(1)(b)”.

### **Holder of a right**

The definition of a “holder of a right” is only used to reference holders of unregistered rights in property.

### **Recommendation**

We suggest that the definition of a “holder of a right”: “Means a holder of a registered or an unregistered right in property”.

### **Property**

“Property” as stated within the Bill is defined as “not limited to land”. This definition implies that the Bill relates to all property, tangible or intangible, and is subject to a legal relationship between persons, with common law enforcing possessory interest or legal title in that thing. This mediating relationship between individual, property and state are known as property regimes. Recognized types of property include:

- Moveable and immovable property;
- Tangible and intangible property;
- Corporeal and incorporeal property.

South Africa recognises certain types of rights in property. These are:

- Real rights, which apply, inter alia, to immovable and moveable property (land and improvements, shares in companies, usufructs etc.);
- Personal rights, for example, personal security, liberty etc.;
- Immaterial property rights, which apply to intellectual property;
- Limited real rights which refers to a restrictive right that a person has over another’s property e.g. a servitude;
- Statutory rights, which refers to legal rights created by the state through legislation.

In looking at the state’s objective in this regard, the objective of the Bill as contained in the “PREAMBLE” predominantly focuses on land reform and to allow the state to “take legislative and other measures to achieve land, water and related reform, in order to redress the results of past racial discrimination...” The Bill therefore provides the state with a tool to achieve its commitment to land reform, and to reforms to bring about equitable access to all South Africa’s natural resources.

If the Bill is intended to be broader and to include all types of property, we would not support this, as this would include intellectual property rights, which could have a large impact on international trade, because such rights are governed by international law/bilateral treaties/covenants/agreements etc. and are subject to international investment law practices/governance frameworks.

### **Recommendation**

The Bill should therefore provide a definition of property beyond merely referring to Section 25 of the Constitution i.e. the definition should explicitly define the classes of property that can be expropriated.



## **Public Interest**

"Public interest" is defined in the Bill as "includes the nation's commitment to land reform, and to reforms to bring about equitable access to all South Africa's natural resources in order to redress the results of past racial discriminatory laws or practices".

We submit that this definition should be redefined within the context of Section 25(2) of the Constitution as:

- "Public interest" could be interpreted to include both 'for profit' and 'not for profit' entities. Outside of land reform and reforms that bring about equitable access to South Africa's natural resources, where beneficiaries would benefit from 'for profit' initiatives, "public interest" should otherwise be restricted to consumptive and non-profit use purposes only. This would be in accordance with the principles of fairness. This would include public facilities and public welfare undertakings that do not aim for profit, but rather to serve the public, and where benefits are shared by society, e.g. roads, military installations, public facilities, government buildings etc. Any other land use should be excluded from the scope of land expropriation;
- Private and public companies as per the definitions (Chapter 1, Interpretation, Purpose and Application) of the Companies Act (2008) and Amendments thereto, that generate profits are not allowed to expropriate property and natural resources to generate profit but are allowed to acquire such property and natural resources through the normal operations of the market (buy and sell). Similarly, state-owned companies that generate profits should not be allowed to expropriate property and natural resources in order to benefit from such expropriation for profit generation purposes, but should only be allowed to expropriate property if the proposed definition of "public interest" is met;
- Third party transfers that benefit a private person (excludes land reform/equitable access to natural resources) but which does not benefit the public in any way should not be allowed and the Minister/the courts should always ensure that this is the case in any expropriation that seems to benefit a third party. Further, expropriations that benefit a third party that provides a public utility should only be allowed as far as they satisfy the "public interest" requirement.

There are numerous international examples where failure to more accurately define "public interest" has led to third party transfers that benefit a private person but not the public. Internationally, expropriation law for "public interest" purposes is therefore strictly defined, listing those entities that may expropriate property and defining the methodologies that must be adopted by them for doing so.

This would include:

- Generalisation (defining the "public interest" need e.g. public engineering construction, state subsidy housing etc.);
- Enumeration (for setting up various social public undertakings e.g. roads, parks etc.);
- A combination of the above two focus areas e.g. setting up public undertakings such as a water conservancy, land reform, equitable access to natural resources etc.;
- Elimination (exclusions are specified).

Further, if the expropriation of a property/portion of a property will have a negative impact on the market value of the remaining portion of a property or adjacent

properties, the owner/s of such properties should have the right to request that these properties should also be expropriated e.g. a property/portion of a property is expropriated for usage as a national road. This would negatively impact on the market value of the remainder of the property/properties adjacent to the road and such an owner/s would be unfairly prejudiced were they unable to request that these properties too be expropriated.

### **Recommendations**

The definition of "public interest" should be aligned to Section 25 (4)(a) and (b) of the Constitution.

New insertion into the Bill:

"The owner/s of the remaining portion of a property/adjacent property have the right to request that these properties be expropriated if the initial expropriation negatively impacts on the market value of their property/properties. Disputes as to whether the initial expropriation has impacted on such property values or expropriation compensation levels are to be resolved through the courts".

### **Public Purpose**

"Public purpose" is defined as "includes any purposes connected with the administration of the provisions of any law or practices". We submit that this definition is incomplete as there is a need for clear regulation of the "public purpose" requirement in legislation to ensure conformity with Section 25(2) of the Constitution. This would also align the definition to international norms where the principle of requiring a strong indication of public necessity in applying the "public purpose" requirement is scrutinised by the courts and it places an onus on the state to provide a detailed and specific motivation as to the necessity for an expropriation to occur. The UN (United Nations Conference on Trade and Development (2012)) states that there is no single definition to effectively capture the meaning of "public purpose". However, the UN report also states that the concept of "public purpose" is the pursuance of a legitimate welfare objective, as opposed to private gain or an illicit end.

### **Recommendations**

The definition for "public purpose" should be aligned to Section 25(2) of the Constitution.

A provision for Regulations which detail qualifying activities for "public purpose" should be added into the Bill.

Moreover, there is a need for clarity to ensure conformity with Section 25(2) of the Constitution which demonstrate public necessity: Constitutional Court cases: Fnb v SARS, Bissett v Buffalo City Municipality, amongst others refer.)

## **Chapter 2 - Powers of Minister of Public Works to Expropriate**

### **Section 3(2)**

The wording used in sub-clause 2 states that the Minister "must" expropriate property when requested by another organ of the state to do so. The use of the word "must" instead of the word "may" limits the discretion of the Minister. However, it does not exclude the Minister entirely as it is qualified by the words "satisfies the Minister". This would therefore imply that the Minister can only refuse a request for expropriation if it is not in the "public interest" or for a "public purpose". This could be particularly problematic in instances when the Minister should be rightfully allowed to deny a request due to other legitimate reasons e.g. the expropriation of a property is not



deemed as a priority, or there is insufficient budget at the time to pay “just and equitable” compensation.

**Recommendation**

We recommend that the word “must” be replaced with the word “may”.

**Section 3(5)**

This section provides that ownership of property expropriated by the Minister will vest in the state. This however poses the question as to whether the property use will be restricted to the stated purpose of the expropriation, as the intended use of the property impacts the amount of compensation that is deemed to be “just and equitable”.

**Recommendation**

The Bill should state that the expropriated property must be used for the purpose it was expropriated and that it cannot be used for any other purpose without the state reviewing the quantum of the compensation paid to reflect “just and equitable” compensation based on the alternative property use.

**Chapter 4 - Intention to Expropriate and Expropriation of Property**

**Section 7(1)**

The notice of intention to expropriate land is not required to be filed with the Registrar of Deeds. This may have a material impact on lenders in instances where they considering providing a loan facility with the property providing supporting security for the loan. In such instances the owner is aware of the intended expropriation, agrees with the authority on the amount of compensation to be paid, but allows the lender to utilise the property as security for the loan prior to the expropriating notice being filed with the Registrar (as provided for in Section 8 of the Bill).

**Recommendation**

We recommend that clause 7 (1) (a) be amended to read “serve a notice of intention to expropriate on the owner, any known holder of a right in the property and on the Registrar of Deeds”.

**Section 9(1)(d)**

This section provides that expropriated property will not remain subject to a mortgage if the property has been so mortgaged. In terms of section 18, compensation will not be paid to a person other than the person as agreed between the expropriated owner and the mortgagee. If no agreement is reached within the prescribed time, the compensation money will be deposited with the Master.

This suggests that mortgage bonds are not registered (real) rights and that it may be disposed of without consultation with the holder of the mortgage bond. The only requirement appears to be that the mortgagee must be served with the notice of expropriation. If such registered rights are undermined, and the full amount is not paid, mortgagees may suffer losses.

This negatively impacts mortgagees in the following ways:

- The mortgagee will lose its security in support of the loan;
- Although the mortgaged property has been expropriated by the state, the state extricates itself from dealing with consequences attendant to the mortgage (the expropriated owner and mortgagee are left to deal with the impact of an expropriation);

- If the amount of compensation is less than the amount of the loan which is secured by the mortgage, the Bill is silent on how the mortgagee should be made whole in the circumstances; and
- The Bill also seems to suggest that if the mortgagee and the expropriated owner cannot agree, or if there is a dispute against the expropriating authority in respect of compensation offered, they can approach a court. This will likely result in the courts being further over-burdened.

This poses challenges in respect of the principle of administration of justice, as well as on the parties who will have to go to court and need to bear the burden of legal costs.

Please see further salient comments in respect of Section 12(1) below on this matter.

### ***Recommendation***

We recommend that the words “with the exception of a mortgage” be deleted.

### **Section 9(5)**

This clause holds an expropriated owner or expropriated holder liable for payment of municipal property rates and other charges until the date referred to in sub-section 9 (2)(b) of the Bill. We submit that given the real right that mortgagees enjoy, that this clause should also compel an expropriated owner or expropriated holder to also be responsible for continued mortgagor repayment obligations.

### ***Recommendation***

We suggest that section 9(5) be amended to include after the reference to 2(b), “and unless the compensation has been determined as nil, remains responsible for the payment of municipal property rates and other charges, if applicable, but also remains liable for repayments in terms of the mortgage bond loan, if applicable, and normal operating costs...”

### **Section 11(1)**

The holder of an unregistered right in property is entitled to compensation. We submit that a bondholder (the holder of a registered right) should be given an equal right.

### ***Recommendation***

Based on our proposed amendment to the definition of an “expropriated holder”, this clause should be amended to reflect a deletion of “unregistered right” and be referenced to “expropriated holder” (as this includes both holders of registered and unregistered rights).

## **Chapter 5 - Compensation for Expropriation**

### **Section 12(1)**

The Bill aims to align this section to section 25(3) of the Constitution, which determines the quantum of compensation paid by the expropriating authority to the owner. This may adversely affect financial institutions who provide credit based on market value as the Banks Act and Regulations related to this Act (Regulations 23 & 24 of 2012) compel financial institutions to value property as an asset class at market value. In turn, South Africa’s Banks Act and its Regulations are aligned to global international regulatory frameworks and prudential frameworks (Basel).

Should the compensation paid by the expropriating authority be less than market value, in some cases outstanding loan balances would exceed the compensation amount paid and financial institutions and owners would suffer a loss. The inadequate management

of credit risk can lead to systemic consequences for the economy and the financial system as evidenced by the 2007 global financial crisis. A critical consequence of the Bill would therefore be a negative impact on the stability of or losses suffered by commercial banks.

This would in turn result in:

- Lenders adopting a more conservative approach to the extent of loans they would be prepared to provide as compared to property values; and/or
- Lenders increasing borrowing interest rates to compensate for the additional risk (and potential losses) in the event of expropriation;
- If losses are severe enough, private sector lenders withdrawing from providing loans where property is being offered for security, thus sterilizing the market.

This would promote food insecurity, job losses, financial exclusion and consequently result in adverse pricing for first time home buyers and be especially contrary to the efforts being made in relation to land reform. In stakeholder engagements with the Department of Rural Development and Land Reform (DRDLR), DRDLR recognised the need for the state to avoid such a situation. Cabinet therefore approved the DRDLR policy framework document styled: "A policy framework for land acquisition and land valuation in a land reform context and for the establishment of the Office of the Valuer General dated 18 October 2012".

Extracts from this paper are the following:

"The market value of property be aligned with the international definition and be interpreted to exclude prices paid by Government as evidence for market value. This will have the immediate effect of aligning prices paid by Government with private lenders.

The change to "just and equitable" which was provided for in the document would have negative implications on the collateral value of existing debt. This has a domino effect as the capital adequacy of these institutions and their ability to provide loans to the agricultural sector is negatively affected, thus having serious implications on food, security and employment.

In order to mitigate these negative implications, Government should automatically guarantee the difference between "just and equitable" compensation as contemplated in s25(3) of the Constitution and "market value" for private sector lenders.

The Bill should provide for the Cabinet approved policy framework".

### ***Recommendation***

A clause should be added to this section as approved by Cabinet that would allow the state to guarantee the difference between "just and equitable" compensation and "market value" for private sector lenders, which payment is restricted to the shortfall between the level of outstanding monies and the quantum of "just and equitable" compensation.

### **Section 12(3)**

This clause makes provision for nil compensation to be paid in certain circumstances (listed in clause (12)(3) (a-e)). However, the clause has a caveat which indicates that nil compensation is not limited to the instances listed in the Bill. This would imply that nil compensation can apply to all instances of expropriation in the "public interest". The implication is that this would have a devastating impact on land rights and land being

viewed as an attractive asset class and consequently local and foreign investment into land. Whilst we view this as unnecessary (see paragraph below), we are of the view that it would be appropriate to have a definitive list of instances which can only be extended on good cause shown and if such an extension is for a “public purpose” or in the “public interest” and which is aligned with the objectives of the Bill and Section 25 of the Constitution.

As a matter of principle, we are not supportive of the principle of expropriation without compensation as this constitutes a dilution of property rights. In 2018, The Banking Association made a substantive submission to the Constitutional Review Committee in this regard, where we argued that based on the opinions expressed by subject matter experts, including ex Constitutional Court judges, that there is no need to change Section 25 of the Constitution, as section 25(3) already makes provision for “just and equitable” compensation to be paid, which compensation could range from R nil (e.g. in instances where outstanding municipal rates and taxes are greater than the market value of the property) to above market value. For the state to highlight five categories but not necessarily confine expropriation for nil compensation to be paid for these categories is we believe unnecessary and problematic, as it creates unnecessary local and international investor angst. In all instances, compensation levels following expropriation should be subject to a formula-based calculation methodology aligned to Section 25(3) of the Constitution, with the detailed methodology contained within Regulations to this Bill.

### ***Recommendations***

We recommend that the proposed insertion of Section 12 (3) be deleted and that this is substituted with an insertion referencing the need for a methodology for the calculation of “just and equitable” compensation through Regulations to this Bill.

Outside of this we wish to further expand on the following issues created by the insertion of this clause:

### **Section 12(3)(b)**

This clause makes provision for nil compensation to be paid in instances where land is held for purely speculative purposes. The Bill does not define “speculative purposes”. Speculation could be considered as a broad range of activities from land holding to land being processed through a town planning process. Such a clause also places risk on owners of properties where immediate improvements cannot be made due to financial constraints. Moreover, in certain circumstances developers purchase a peri-urban property for development at a future date. Such a clause could thus stall human settlement development in peri-urban areas. Further, should the property of a land developer be expropriated without the payment of fair compensation, this would contaminate any further land purchasers of land by developers for usage at a future date. This is particularly important given that cities continue to expand due to population growth, and this restriction could sterilize property development in new development areas.

Placing such a broad restriction on land also reflects a dilution of property rights as one of the fundamental rights of property ownership and a free market economy is the autonomy to decide how best to use one’s own property. It also discriminates against lawful speculation in land as an asset class, as opposed to other classes of assets where ‘speculation’ is not penalised or outlawed.



**Recommendation**

This clause should be removed from the Bill, or at the least a timeframe be inserted that allows for land to be held for speculative purposes for a reasonable amount of time. If this clause is not removed from the Bill, then at minimum a definition for what constitutes speculation should be detailed.

**Section 12(3)(c)**

This clause makes provision for the land of a state-owned corporation or entity to be expropriated without compensation. However, clause 2(2) *Application of Act*, severely limits the potential for state-owned land from being expropriated unless this is consented to by "the executive authority responsible for that corporation or entity". State-owned land, including that owned by state-owned entities constitutes 25,2 million hectares, with 2.9 million hectares being unused. It follows that a major land redistribution opportunity exists within this ambit of land. It is however highly unlikely that "executive authorities" will consent to their land being expropriated without any compensation if they would be able to sell this in the market at market value.

**Recommendation**

The Minister should be able to decide without the consent of the executive authority to expropriate state-owned land. The executive authority however should be able to review the decision based on municipal Spatial Development Plans which are required in terms of the Spatial Planning and Land Use Management Act (2015)

**Section 12(3)(d)**

As in clause 12 (3)(b), there is no definition for abandoned land. This Bill does not consider the reasons why land could be abandoned. There are instances where owners cannot access their land or have lost control of their property due to circumstances outside of their control e.g. land occupied by informal dwellers/hijacked buildings, land invasions etc.

**Recommendation**

The proposed methodology for determining "just and equitable" compensation would determine what the expropriation value of the property would be.

**Section 12(3)(e)**

This clause makes provision for nil compensation to be paid in circumstances where the state has invested a greater or equal amount in the property than its market value. This clause is ambiguous as it does not clarify the circumstances under which this clause may apply.

**Recommendation**

This clause should detail what constitutes state investment into a property in order to remove any ambiguity.

**Section 13**

The expropriated owner is to be paid interest stipulated by section 80(1)(b) of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA). However, an owner may be required to pay a higher interest rate to a financial institution than that stipulated by the PFMA.

**Recommendation**

Should the expropriated owner be required to pay a higher interest rate to a financial institution as compared to that stipulated within the PFMA, the owner should be compensated for the additional net difference in interest that has been paid.

## **Section 18**

This clause provides for property subject to a mortgage bond or deed of sale. Clause 8 of the Bill makes it clear that if land in which unregistered rights exist is expropriated, the expropriating authority must offer compensation for both the land and to the unregistered right holder. The clause is less clear in the context of mortgage bonds specifically in relation to clause 8(3)(g), as this clause does not compel the expropriating authority to offer compensation to the holder of a mortgage bond over the property in respect of the termination of his rights under the bond. This effectively is a dilution of the real rights of registered rights holders. The Insolvency Act no. 24 of 1936 protects the holder of a mortgage bond by making such a holder a secured creditor. The Bill should not disregard other entrenched legislation and it follows that the proceeds must be paid directly to the mortgagee and not to the claimant.

### ***Recommendation***

This should be cross referenced to clause 11 (1) and our related comments to this clause.

If the intention of S18(1) is that compensation must first be offered to the mortgagee - appropriate amendments would need to be made in the Bill in order to reflect that in any instance where property is subject to a mortgage bond, the expropriating authority must offer compensation, not just for the property but for the mortgage bond as well. The total amount offered should be divided between the property owner and the mortgagee (premised upon the secured debt being expunged). This should be done in accordance to:

- factors listed in Section 12 (clauses 1 and 2);
- the amount owing under the mortgage bond should be paid to the mortgagee first (as required by the Insolvency Act);
- if there is a dispute concerning compensation, this should be settled by way of the courts.

## **Section 19(1)**

This section references 'rates, taxes and other charges that must be paid for ownership to be transferred in the deeds office', but it does not specify that this amount must be limited to the amounts payable under Section 118 of the Municipal Systems Act of 2000, where Section 118(1) restricts collection to a period of two years and Section 118(3) includes collection of all amounts without restriction or prescription, but which in practice is restricted to 30 years in terms of the Income Tax Act 58 of 1962 and Amendments thereto.

### ***Recommendation***

Referencing section 118(1) and (3) of the Municipal Systems Act of 2000 in this section will protect all stakeholders in the expropriation process.

## **Conclusion**

Whilst we have highlighted a number of aspects which we believe requires address, we are of the view that this version of the draft Bill reflects a substantive improvement on past drafts. We do however caution that the envisaged expropriation interventions should not dilute property rights or be applied injudiciously, failing which local and international investor confidence in property as an attractive asset class could be undermined and which in turn could destabilise the financial system and ultimately the greater economy of the country.



Yours faithfully

A handwritten signature in black ink, appearing to read "Pierre Venter", with a horizontal line underneath the name.

Pierre Venter

General Manager

Market Conduct Division

