



Estimation of the Compensation Amount in the Process of Expropriation of Real Estate in the Republic of Moldova

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Abstract

Expropriation is the transfer of assets and ownership rights from private to public property, after a fair and previously determined compensation. The Constitution of the Republic of Moldova, the Civil Code and the Land Code stipulates a “fair and previously determined compensation” in case of ownership transfer. The existing legislative acts in the Republic of Moldova explain the expropriation procedure, but do not cover the estimation process of the compensations and damages caused by the expropriation. In the present study, the authors examine the existing legislative and methodological framework used in the process of estimation process of the compensations amount. The notions of “normative price” and “market price” as “fair compensation” are examined. The challenges and legislative gaps that exist at each stage of the compensation assessment process in case of expropriation of real estate are analyzed. It has been found that the national practice of estimating the damage in case of expropriation for public utility does not ensure the compliance with the principles of equivalence and fails to achieve equitable treatment of the interests of both the private owners and the public administration bodies. It has been observed that the state is damaged by the lack of certainty regarding the valuation date for the assessment of compensation, the owners by not considering some categories of losses, and both parties by the lack of methodological provisions on assessing compensation for expropriation. Based on the research carried out, the authors propose their own methodology for assessing the compensation amount in case of expropriation for public utility in the conditions of the Republic of Moldova.

Subject Areas

Economics of Law

Keywords

Methodology, Real Estate Valuation, Patrimonial Damage, Moldova

1. Introduction

The expropriation represents the transfer of assets and property rights from private to public ownership; the transfer to the State of public property belonging to an administrative-territorial unit; or, where appropriate, the transfer to the State or to an administrative-territorial unit of property rights for the purpose of carrying out public utility works of national or local level, under the conditions provided by the law, after a fair and prior compensation ([1], art.1).

The Constitution of the Republic of Moldova [2], the Civil Code [3], and the Land Code [4] stipulates a “fair and previously determined compensation” in case of property transfer. Some gaps were found in the legislative framework after carrying out an analysis. The existing legislative acts explain the expropriation procedure, but do not cover the estimation process of the compensations and damages caused by the expropriation [5]. Various methods have been applied during the research of this aspect, such as elements of the systemic approach, the method of analysis and synthesis, deduction and analogy, comparative analysis, and modelling.

In this article, the authors analyse the current methodological framework (Section 2), emphasize the challenges and legislative gaps (Section 3) and propose their own Methodology for estimating the amount of compensation in the event of expropriation for public utility in the conditions of the Republic of Moldova (Section 4).

2. Current Methodological Framework

Currently, the estimation of compensations in the Republic of Moldova is subject to the provisions of Law No. 1308 of 25.07.1997 on normative price and procedure of sale and purchase of land, Article 17: *Compensation of the losses caused by the forced alienation of lands*, which stipulates that: “Compensation of the losses caused by the forced alienation of land shall be done at market price, but not less than the *normative price* calculated according to the tariffs indicated under heading II of the annex” [6].

The normative price of the land is calculated according to the Equation (1):

$$NP = T \times SF \times S \quad (1)$$

where: T —tariff (coefficient), SF —soil fertility, S —land area.

The tariff for calculating the normative price of land for the forced alienation of agricultural land, plots of land next to the houses, and fruit plots constitutes 1242.08 Moldovan lei for one degree/hectare.

The normative price of agricultural land is calculated depending on the aver-

age fertility of the soil established for the given city, village (commune), or at the request of the owner, depending on the soil fertility established for the respective plot.

The estimation of the “market price” is subject to the provisions of:

1) Law on Evaluation Activity no. 989-XV of April 18, 2002 [7] requires in Article 5 a mandatory “object valuation in case of expropriation for public utility”, and

2) Government Decision No. 958 of 04.08.2003 on the approval of the Provisional Regulation on the valuation of real estate [8], the purpose of which is to “establish the procedure for determining the value of real estate, regardless of the type and form of their ownership.”

The market value estimation algorithm recommended by the Provisional Regulation consists of the following steps:

1) *The Scope of Work of the valuation mission* is established by the valuer together with the beneficiary of the valuation advice. It describes the fundamental conditions and criteria for carrying out the valuation. The description of the evaluation mission consists of the following elements:

- identification the asset being valued;
- identification of the ownership rights over the valued asset;
- identification of the purpose of the valuation;
- definition of the bases of value;
- identification of the scope of the valuation results;
- identification of limitations underlying the valuation.

2) *The collection and analysis of data necessary for the valuation.* The valuer’s activities at this stage are related to the study of the real estate market in general and the description of the asset being valued, in order to carry out a detailed analysis of the factors influencing its value. The valuer will collect and analyse the following categories of data:

- general economic and social data about the region and locality in which the real estate is located;
- data specific to the asset being valued: use of the asset, the best and most efficient use of the asset, construction costs, depreciation, income and operating expenses;
- data specific to the real estate market: sale prices and offer prices of similar assets, absorption rate, vacancy rate, and other.

3) *The application of valuation methods.* The following methods shall be used to determine the value of the real estate: the Cost Approach, the Comparative Analysis of Sales Approach and the Income Approach. If the use of one of the methods referred to is not possible, the valuer shall argue in the valuation report that the method cannot be used. In the case of valuation of different types of real estate, the valuation methods will be applied in the following sequence:

- for the valuation of residential real estate: the Comparative Analysis of Sales Approach and the Cost Approach. The Income Approach can be applied for

the valuation of residential real estate that are leased;

- for land valuation, including agricultural land: the Comparative Analysis of Sales Approach and the Income Approach;
- for the valuation of commercial real estate: the Comparative Analysis of Sales Approach, the Income Approach and the Cost Approach;
- for the valuation of industrial real estate:
 - in the case of a developed market: the Comparative Analysis of Sales Approach, the Income Approach and the Cost Approach;
 - in the case of a poorly developed market or its non-existence: the Cost Approach;
- for the valuation of unique and specialized real estate: the Cost Approach.

4) *The reconciliation of values and the estimation of the final value.* Different values can be obtained by applying multiple valuation metrics. At the reconciliation stage the valuer shall determine the final value of the real estate based on the results obtained from the application of the valuation methods.

5) *The preparation of the valuation report.* The valuation report is an act drawn up by the valuer and presented to the beneficiary of the valuation advice justifying the assessment of the value of the real estate.

3. Challenges and Legislative Gaps

Each stage of the real estate valuation process should be analysed in terms of the expropriation process.

3.1. The Scope of Work of the Valuation Mission

- ✓ The identification the asset being valued and the ownership rights over it are included in the annex to the law on the declaration of public utility and assets expropriation.
- ✓ The purpose of the valuation is the expropriation for public utility.
- ✓ Some controversies arise at the stage of identifying the bases of value. Since the term “market price” is indicated in the legislation, the type of value should be in accordance with Point 126 of the provisional Regulation:
 - the fair value, which is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. (according to International Financial Reporting Standard 13 [9]) or
 - the equitable value, which is “the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties” (according to International Valuation Standards [10]).

Equitable Value requires the assessment of the price that is fair between two specific, identified parties considering the respective advantages or disadvantages that each will gain from the transaction. In contrast, Market Value requires any advantages or disadvantages that would not be available to, or incurred by,

market participants generally to be disregarded.

Equitable Value is a broader concept than Market Value. Although in many cases the price that is fair between two parties will equate to that obtainable in the market, there will be cases where the assessment of Equitable Value will involve taking into account matters that have to be disregarded in the assessment of Market Value, such as certain elements of Synergistic Value arising because of the combination of the interests.

An explanation of basis of value in case of expropriation can be found in The European Valuation Standards TEGOVA [11] that stipulates: Value for Compulsory Purchase and/or Compensation, where national or local government bodies acquire property compulsorily in order to carry out public interest schemes it is usual for the owner (and the occupiers, if any) to receive appropriate compensation payments. While compensation for loss of property is often based on Market Value, this principle may be modified by national or local law and legal precedent.

- The definition of “market value” does not include the word “price”: the market value is “the estimated amount for which the object of valuation could be exchanged on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion” [8].

As it is stipulated in IVS market value conceptual framework [10] “the estimated amount” refers to a *price* expressed in terms of money payable for the asset in an arm’s length market transaction. Market Value is the most probable price reasonably obtainable in the market on the valuation date in keeping with the market value definition. It is the best price reasonably obtainable by the seller and the most advantageous price obtainable by the buyer after negotiations. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of value available only to a specific owner or purchaser.

Therefore, under current legislation, any of the three types of values (fair, equitable, market values) can be assessed for expropriation purposes.

The bases of value are determined according to the premise of value (or assumed use), which describes the conditions under which the expropriated asset is used. Different bases of value may require a particular Premise of Value or allow the consideration of multiple Premises of Value. Some common Premises of Value are:

- 1) highest and best use,
- 2) current use/existing use,
- 3) orderly liquidation, and
- 4) forced sale.

Highest and best use is the use, from a participant perspective, that would produce the highest value for an asset. The highest and best use must be physi-

cally possible (where applicable), financially feasible, legally allowed and result in the highest value. If different from the current use, the costs to convert an asset to its highest and best use would impact the value.

The highest and best use for an asset may be its current or existing use when it is being used optimally. However, highest and best use may differ from current use or even be an orderly liquidation.

Current use/existing use is the current way an asset, liability, or group of assets and/or liabilities is used. The current use may be, but is not necessarily, also the highest and best use.

An *orderly liquidation* describes the value of a group of assets that could be realised in a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis. The reasonable period of time to find a purchaser (or purchasers) may vary by asset type and market conditions.

Forced Sale. The term “forced sale” is often used in circumstances where a seller is under compulsion to sell and that, as a consequence, a proper marketing period is not possible and buyers may not be able to undertake adequate due diligence. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller and the reasons why proper marketing cannot be undertaken. It may also reflect the consequences for the seller of failing to sell within the period available. Unless the nature of, and the reason for, the constraints on the seller are known, the price obtainable in a forced sale cannot be realistically estimated. The price that a seller will accept in a forced sale will reflect its particular circumstances, rather than those of the hypothetical willing seller in the market value definition. A “forced sale” is a description of the situation under which the exchange takes place, not a distinct basis of value.

If an indication of the price obtainable under forced sale circumstances is required, it will be necessary to clearly identify the reasons for the constraint on the seller, including the consequences of failing to sell in the specified period by setting out appropriate assumptions. If these circumstances do not exist at the valuation date, these must be clearly identified as special assumptions.

Expropriation can be considered a forced sale. However, the value of the expropriated property must repair the damage caused by expropriation, which implies to put the injured party in the same position as he would have been in if the expropriation had not occurred.

Therefore, the value depends on the *subjective opinion, knowledge, experience, and professional competence of the valuer.*

- ✓ The valuation date is to be established (see the definitions of the value) along with the bases of value and premises of value. As a rule, the valuation date of a real estate corresponds to date on which investigations are to be undertaken or completed, because, according to the conceptual framework, “at the valuation date” requires that the value be specific to a time point, *i.e.*, to a certain date. As markets and market conditions may change, the assessed value may

be incorrect or inappropriate for another date. The value will reflect the state and circumstances of the market, as they are at the valuation date, and not those related to any other date.

An eloquent example is the construction of the Ungheni-Chisinau natural gas pipeline [12] [13]. The official announcement of the initiation of the project was in 2015, followed by the adoption of the expropriation law for the Ungheni-Chisinau gas pipeline in June 2017. The market value assessment was completed by the end of 2018. The valuation period lasted from August to December 2018. The date of each valuation corresponded to the date of inspection of the expropriated land. However, already during this period, land prices have increased considerably since the period of the initiation of the expropriation project for public utility. Simultaneously, in some areas the land market practically did not exist.

Expropriation projects are often accompanied by atypical real estate market situations [14]:

- There are no market conditions for the free formation of prices (there is an obligation for the owners to sell and for the state to buy the land).
- Transactions of speculative nature can appear. The owners are trying to get additional income in the expropriation process.
- Changes in land use. In the practice of the Russian Federation there were cases when, as a consequence of the appearance of the information on land expropriation for certain purposes, the owners changed the land use, which resulted in a considerable increase in market value.
- There is interest from local investors to purchase land in order to sell it to the state.

Therefore, it has to be concluded that the correct assessment of the valuation date is highly important. However, information on this subject in the legislation of the Republic of Moldova is omitted.

- ✓ the scope of the valuation assignment is the payment by the state of the compensations to the owners;
- ✓ the limitations underlying the valuation include the common provisions and limiting conditions specific to the particular expropriation project.

3.2. Collection and Analysis of Data

- ✓ General economic and social data about the region and locality in which the property is located are necessary, in particular, for the assessment of the market as a whole and the correct selection of valuation methods.
- ✓ data specific to the asset being valued:
 - current land use,
 - analysis of the highest and best use of the asset being valued is not necessary for the expropriation purposes,
 - construction costs are necessary only in the event of permanent or provisional expropriation of buildings or damage to buildings located in the area of expropriations,

- depreciation will be estimated only if the previous condition is met,
- income and operating expenses are the basic data used for damage estimation in case of provisional expropriation, this information is also useful in situations of the valuation of assets expropriated on a permanent basis;
- ✓ data specific to the real estate market: sale prices and offer prices of similar assets, absorption rate, vacancy rate, and other are mandatory data, including in the case of valuation for expropriation.

3.3. Application of Valuation Methods

- ✓ Predominantly land is subject to expropriations. Its value, including agricultural land value, is recommended to be assessed by the Comparative Analysis of Sales Approach and Income Approach. For the purpose of expropriation, it is recommended to apply the normative price method in order to assess the amount of compensation.

The problem is that in rural areas where there is a market, the prices negotiated in transactions are lower than the normative price, and in zones closer to urban areas (especially the capital) market prices are higher compared to the normative price.

The land expropriation process also influences the land market in the neighbouring areas. There is a direct dependence between the increase in prices for the land to be expropriated, those located in its immediate vicinity, and for the lots located in the vicinity of the area where the project will take place.

Only lands located far enough from the object of expropriation are not influenced by the decision on expropriation, and their value is influenced by the factors common to the real estate market. These lands value remains constant, the value will not involve considerable differences at different stages of project implementation and speculative factors are missing for these lands, therefore they can be used as similar assets in the valuation procedure of lands subject to expropriation.

In many countries there are issues related to speculation with real estate, including land that should be expropriated for public utility needs. Solving these problems will help to develop the market and it will make it more transparent. It will also support effective decision making on development of capital constructions projects, avoiding market speculation due to the change in land value.

The above demonstrates that the process of real estate expropriation significantly affects the entire real estate market. The changes start from the waiting period, *i.e.*, from the moment of the dissemination of information on the construction of an object for public utility without announcing the date of adoption of the decision. According to practice, a long period of time between these two stages allows speculative transactions. This leads to unfair enrichment of some owners and to unjustified expenditure from public administration funds (local or central).

The existing legislative framework, respecting the condition for determining

the compensation as the maximum amount between the “normative price” and the “market price”, creates premises for the unjustified increase of budgetary expenditures.

- ✓ The buildings for residential and commercial use, as a rule, are not subject to expropriation for public utility, except for some constructions with cultural value (historical, architectural) which are intended for future generations.
- ✓ The valuation of industrial real estate will be performed by applying methods from all three approaches in valuation, and in the case of a poorly developed market or its non-existence the Cost Approach.

3.4. The Reconciliation of Values and the Estimation of Final Value

For the purpose of expropriation this step becomes unnecessary in most cases, since the valuer can draw the conclusion based only on one method or approach (in this case internal reconciliation can be performed within the approach framework, a process that differs from reconciling the results of three approaches).

Simultaneously with the permanent expropriation for the accomplishment of the works in community interest, there is a provisional expropriation of the neighbouring property, necessary for the storage of construction materials and equipment, and for access to the site. The owners of these lots are also harmed.

According to Article 14 (2) of the Civil Code [3], “patrimonial damage” shall be deemed to be the expenses which the injured person has incurred or will incur in restoring the right or interest recognized as violated by the law, the destruction or damage of his property (actual damage), and the lost profit as a result of the violation of the right or interest recognized by law (lost profit).

The provisions of the Civil Code Article 14 (paragraphs 5 and 6) should be considered for the estimation of the patrimonial damage:

- paragraph (5) The reparation of the damage implies to put the injured party in the same position as he/she would have been in if the expropriation had not occurred.
- paragraph (6) Instead of repairing the patrimonial damage according to paragraphs (2) and (5), the injured person may request from the person responsible for the damage the recovery of the entire profit that he obtained in connection with the cause of the damage. This rule applies only if the law or the contract provides for such a form of determining the patrimonial damage or if the application of such a form of determining the patrimonial damage is reasonable in the circumstances of the case.

In practice, the compensation for provisional expropriation is estimated by discounting the lost profit for the period of construction works. However, the actual damages are not taken into account, which is prejudicial to the owner.

Generalizing the above, we note that the national practice of damage assessment in case of expropriation for public utility does not ensure the compliance with the principles of equivalence and fails to achieve equitable treatment of the

interests. Compensation must cover the damage of the owners at the same time ensuring that there will be no unjustified expenditure from the public budget.

The current practice allows damages to the state by the lack of certainty regarding the valuation date for the assessment of compensation, to the owners by not considering some categories of damages, and to both parties by the lack of methodological provisions on assessing compensation for expropriation.

4. Assessment of the Compensation Amount

Based on international best practices [15] and on the analysis of gaps in national legislation and national practice in the field of expropriation for public utility [5] [14], it was developed the Methodology for estimating the amount of compensation in the event of expropriation for public utility in the conditions of the Republic of Moldova with the following content:

4.1. The Valuation Process

1) The process of assessing the compensation in the event of expropriation for public utility consist of the following stages:

- a) terms of reference;
- b) data collection and analysis;
- c) determination of the compensation amount;
- d) preparation of the valuation report.

2) The terms of reference include:

a) *Identification of the valuer.* The valuer can be an individual, a group of individuals or a legal entity. The valuer shall be obliged to sign the declaration of absence of conflict of interest.

If the valuer has an interest or a personal/material connection with the subject of the valuation or with the other parties involved in the valuation, or if there is any other factor that could restrict the valuer's ability to perform an objective and unbiased valuation, the valuer should refuse to perform the work. If the valuer needs considerable assistance from other specialists in relation to any aspect of the valuation, the nature of such assistance and the extent of reliance shall be clearly stated.

b) *Identification of the client.*

c) *Identification of the asset to be valued.* The asset shall be clearly identified.

d) *Ownership of the asset(s) subject to valuation.* The property rights and any limitations and encumbrances of such rights shall be identified.

e) *The scope of work* consists in estimating the amount of compensation.

f) *The basis of value:* equitable value.

g) *The valuation date.* The date of the valuation shall correspond to the date of the declaration of public utility.

h) *Nature and extend of investigation and any limitations thereof.* Any limitations or restrictions on the inspection, investigation and/or analysis within the valuation shall be disclosed.

i) *Nature and source* of the information on which the valuer relies. The nature and source of any information on which the valuation will be based, as well as the extent of any steps taken to verify that information during the valuation process shall be disclosed.

j) *Assumptions and/or significant special assumptions*. All assumptions and any significant special assumptions made during the valuation and valuation reporting shall be clearly stated.

3) Data collection and analysis. During this stage, the data needed for valuation are collected and their impact on the estimated value is analysed. The real estate market as a whole and the specific market segments should be studied. The valuer should collect and analyse the following categories of data:

a) general economic and social data about the region and locality in which the property is located;

b) data specific to the subject of the valuation: current use, construction costs, depreciation, income and operating expenses;

c) data specific to the real estate market: sale prices and offer prices of similar assets, dynamics of registered transactions, absorption rate and others.

4) Determining the amount of compensation. The amount of compensations in case of expropriation for public utility shall be determined by the following relation:

$$C = FV + AD + LP + AC \quad (2)$$

where: C —compensation, FV —fair value, LP —lost profit, AD —actual damage, AC —additional costs.

5) The preparation of the valuation report is the final stage of the valuation process. The valuation report is an act drawn up by the valuer which justifies the estimation of the compensation amount.

4.2. Determining the Amount of Compensation

1) **EQUITABLE VALUE**. It is the basic and most important component of compensation. Equitable value is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

2) In the event of lack or underdevelopment of the land/real estate market (less than 5 transactions on average annually in the last 3 years) in the area of real estate expropriation, the Equitable Value will be equal to the Normative Price, determined according to the Law on normative price and procedure of sale and purchase of land.

3) In case the real estate/land market in the expropriation area exists, the Equitable Value of the real estate will be estimated according to the methodology set out in the Provisional Regulation on the valuation of real estate with the following specifications:

a) The premise of value is the use of the asset before declaring the public utility.

b) Market approach. If there are more than 6 months between the date of adoption of the decision on the project for public utility purposes and the valuation date, the similar assets considered in the valuation will be selected from those located at a distance sufficient to exclude the influence of the speculative factor on the prices of transactions/offers.

c) Land valuation will be performed by direct comparison method and/or direct capitalization method.

4) PATRIMONIAL DAMAGE shall be considered the expenses which the injured person has incurred or will incur in restoring the right or interest recognized as violated by the law, the destruction or damage of his property (real damage), and the lost profit as a result of the violation of the right or interest recognized by law (lost profit).

5) The actual damage will be determined by the resource method.

6) The lost profit is generated by the amount of losses incurred by the landowner or the holder of the right to use the land in connection with the early termination of the obligations to third parties. The valuer shall analyse the legislation in force and the contracts concluded between the landowner and third parties in order to determine the types and sizes of obligations incurred by the owners in connection with the non-fulfilment of the contractual terms conditioned by the expropriation of the property. The amount of damages identified during the process of contract analysis should be determined in accordance with the contractual terms.

7) The lost profit shall be determined by the Income Approach Methods.

8) The Discounted Cash Flow method shall be applied to estimate compensation in the event of provisional expropriation. The forecast period shall correspond to the period of construction works increased with the seasonal component (e.g. in the case of covering the period of planting crops and the impossibility for the owner of the profit gain in the current year).

9) ADDITIONAL COSTS. Additional costs include: notarial expenses, expenditures on topographic and geodetic works, expenses regarding the registration of all changes, etc.

10) If the period between the valuation date and the period for payment of the compensation exceeds one calendar year, the amount of the compensation shall be updated. The discount rate consists of the National Bank of Moldova base rate plus 9 percentage points.

5. Conclusions

Based on the research carried out it was found that:

- Controversy occurs at the identification stage of the type of estimated value. Under current legislation for expropriation purposes, any of three types of values can be estimated: market value, fair value, and equitable value in any of the four existing premises (best use, current/existing use, orderly liquidation, and forced sale).

- At the current stage, the value depends on the subjective opinion, knowledge, experience, and professional skills of the valuer.
- The date of valuation is a key aspect in estimating the damage, the lack of information on this subject in the legislation of the Republic of Moldova allows the appearance of speculative transactions.
- The national practice of estimating damage in the event of expropriation for public utility does not ensure compliance with the principles of equivalence and equitable treatment of the interests.
- The current practice allows damages to the state by the lack of certainty regarding the valuation date for the assessment of compensation, to the owners by not considering some categories of damages, and to both parties by the lack of methodological provisions on assessing compensation for expropriation.

These findings were the basis of the “Methodology for estimating the amount of compensation in the event of expropriation for public utility in the conditions of the Republic of Moldova” developed by the authors. The proposed methodology allows the assessment of the amount of compensation in case of expropriation of real estate both permanently and temporarily.

Limitation of Research

The research does not include issues related to some objects of expropriation such as: patrimonial and personal non-patrimonial rights, directly related to inventions that can contribute considerably to the defense and security interests of the country; cultural, artistic and historical values of exceptional importance for the national feelings of the people; and the ownership of the species of flora and fauna for which the natural areas of the Republic of Moldova is suitable for development and reproduction and which are in danger of extinction in the world. These subjects should be addressed separately in future research.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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