

Valuer General's Policy

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Determination of compensation following the acquisition of a business

What

This policy addresses the determination of compensation for a business being conducted on land that is being acquired under the Land Acquisition (Just Terms Compensation) Act 1991 (the Act).

How

This policy applies to all valuations to determine compensation following the acquisition of a business for the purposes of the Act.

Land may be acquired by an authority of the State for a public purpose when the land is not available for sale. The Valuer General determines compensation when an agreement for the purchase of the land cannot be reached between the land owner and the acquiring authority.

Compensation is assessed in accordance with the Act.

Why

This policy will ensure that:

- claimants are justly compensated for the acquisition of a business
- compensation offered to claimants is in line with the Act.

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1 Policy

1.1 Scope

Compensation for business on land that has been compulsorily acquired

This policy should be followed to assess the amount of compensation for a business conducted on land that is acquired in accordance with the Act. Each case should be considered on its individual merits.

The acquired land can be either the whole of the property or part of the property. The business interest may be in the same ownership as the “land” or may be a non-related party.

1.2 Who is entitled to compensation?

The legal status of the business will be considered in determining an entitlement to compensation:

Sole trader

If the business was being conducted by its owner as a sole trader, the business is not a separate legal entity. The business itself does not own an interest in the land in that situation. Therefore, the claim for compensation associated with the sole trading business must be made by the individual(s) who own and operate the business in their personal capacity. This is most commonly done by sole traders as part of their claim as the owner of the land or as a lessee.

Corporation

Where the business was being conducted by a corporation and the corporation has an interest in the land (again usually by way of owning the land or having a lease from the owner), that entity may lodge the claim for compensation. If the corporation owns the land and also operates its business on that same land then there would be only one claim for compensation. If there are different corporations that own the land and operate the business, then separate claims are required.

Sometimes corporations operate businesses on land via a verbal lease or licence. Depending on the circumstances, the corporation may still have an interest in land entitling it to compensation. This may include documentation that clearly demonstrates the payment of rent over a long period of time.

Business must be lawful To be entitled to compensation, the business must be lawful. Compensation is not payable for relocation costs associated with an unlawful enterprise.

Where a business is operating without development consent and consent could be provided by the local council if an application was made, the business owner would still be eligible for compensation. The compensation, however, needs to have regard to the fact that the business does not currently have such approval, the obtaining of which would involve time, cost and risk.

1.3 Nature of the interest in land

When assessing compensation in respect of a business, the nature of the business' interest in the acquired land must be considered. For example, if the business leases the acquired land, the length of the lease will affect the calculation of any market value compensation and the assessment of reasonableness of any disturbance items.

1.4 Market value and disturbance

Market value Typically, a business is not entitled to compensation for market value unless there is a profit rental in existence under a lease. A profit rental is where the current rent being paid is less than the market rent. In these situations, the rental saving is calculated for the term of the saving, normally the un-expired lease term or until the next market rental review. The amount is calculated as a lump sum, present value of the saving for the remaining period of the lease or to the next market rental review.

On rare occasions, the market value of a lease may be established if it can be demonstrated that someone would pay a price for the transfer of a lease, notwithstanding that the rental paid under the lease is a market rent.

Alternatively, if the occupation of land under lease has inherent profit-making features for a particular use, the exploitation of which is largely open to any occupier of that land, a value over and above a profit rent may exist. In that case, it may be appropriate to value the lease by using a discounted cash flow methodology.

Disturbance items References to "persons" in the Act includes businesses where appropriate. Claims by a business have historically been made as a claim for disturbance. Depending on the

circumstances of each individual case, the typical categories of disturbance that may be claimed by a business under Section 59(1) of the Act are:

- (a) **legal costs** reasonably incurred by the persons entitled to compensation in connection with the compulsory acquisition of the land
- (b) **valuation fees** of a qualified valuer reasonably incurred by those persons in connection with the compulsory acquisition of the land (but not fees calculated by reference to the value, as assessed by the valuer, of the land)
- (c) **financial costs** reasonably incurred in connection with the **relocation** of those persons (including legal costs but not including stamp duty or mortgage costs)
- (d) **stamp duty costs** reasonably incurred (or that might reasonably be incurred) by those persons in connection with the purchase of land for relocation (but not exceeding the amount that would be incurred for the purchase of land of equivalent value to the land compulsorily acquired),
- (e) **any other financial costs** reasonably incurred (or that might reasonably be incurred), relating to the actual use of the land, as a direct and natural consequence of the acquisition.

Relocation or extinguishment

Compensation may be calculated on the basis of relocation of the business or extinguishment of the business.

Compensation for relocation of the business will be considered where the business is able to demonstrate a real and not remote intention to relocate, with a reasonable prospect of relocation in the circumstances.

Compensation for extinguishment of the business will be considered where there is no demonstrated intention to relocate, the intention to relocate is remote, relocation is not feasible or the business cannot be relocated.

Relocation cost is covered in section 59(1)(c) of the Act.

Extinguishment has typically been covered by section 59(1)(f) of the Act as *any other financial costs* and, in simple terms, represents the value of the business as a going concern if sold or purchased.

Relocation

The types of relocation costs that may be claimed are broad. Each situation will be different and must be considered on its merits.

Typical relocation costs claimable under section 59(1)(c) by the owner of a business interest may include, but are not limited to:

- legal costs
- valuation fees
- professional costs (such as engineers or town planners) relating to securing a replacement location
- buyers/lessee's agent costs if:
 - the claimant is resident overseas and only visits Australia infrequently; or
 - the technical specifications of the property or business are of such complexity that the claimant is unable to undertake an alternative property search himself/herself; or
 - such reason as the Valuer General may consider reasonable.
- fit-out costs for the replacement location
- new signage
- costs of reprinting stationary
- notification of new address to customers
- costs of relocating telephones and internet services
- costs of removing and installing computers
- general removal expenses
- stock losses (not the value of the stock on hand)
- Australia Post mail redirection
- loss of business profits due to acquisition.

An important principle of business compensation is that the costs of re-establishing improvements that existed on the acquired land cannot be claimed if they were included in the assessment of market value. To do so would be compensating for the same item twice. For example, if the claimant was compensated for the value of a loading dock in the acquired premises, then the costs of installing a loading dock on the new premises would not be claimable. However, it may be appropriate to allow such works as fit out costs of a new premises if the landlord and tenant are different.

Current law says that the incurring of the costs must be reasonable, not the costs themselves. If it is otherwise reasonable to physically relocate in the circumstances, the only limit on the quantum of the costs to relocate is that they not be exorbitant. That is because the incurring of exorbitant costs could not be characterised as being “reasonably incurred”.

The assessment of compensation for business disturbance must be made whether the costs associated have actually been incurred or not. Costs that have not occurred at the date of acquisition but which might be reasonably incurred are still to be considered.

However, it must be reasonable that they would be incurred. The term ‘incurred’ is to be given the broadest interpretation possible, as it relates to costs that might reasonably be expected to be incurred given the balance of probability.

Professional fees for legal, valuation and other services must relate directly to the acquisition. No amounts are assessed for possible future court action which may or may not eventuate. If court action were to occur the business will have a further opportunity to have costs considered.

Compensation for a business is limited to financial costs reasonably incurred or that might reasonably be incurred as a direct result of the acquisition.

Secondary impacts due to the nature of the works constructed on the acquired land may only be considered as part of a claim that includes a claim under s. 55(f) of the Act.

For example, if the design of the works limits access to a site, that may be a loss to the market value of the land, however, it is not a direct financial cost which is compensable for the business, as such a loss would arise from the carrying out of the public purpose rather than from the acquisition.

Future lost profits

Future lost profits for the reasonable time it takes to relocate and re-establish a business enterprise can be considered as a disturbance item.

No compensation is to be determined for future lost profits due to the unrealised potential of land. Such potential is contained within the market value.

Paying a higher rent at new location

The underlying principal of just compensation is to ensure the disposed owner is not placed in a better or worse position as a result of the acquisition. There may be occasions when a business interest relocates but is required to pay more rent in

the new location. Compensation is to include the extra rental required, as long as there is no additional income or saving benefits to the business and it should be calculated for the remaining period of the lease that the business had before the acquisition.

1.5 Extinguishment and tax

Extinguishment

Extinguishment represents the value of the business if sold as a going concern. The most appropriate method to value a business as a going concern is likely to be by the capitalisation of future maintainable earnings.

No compensation is to be determined for lost future profits as this is accounted for in the value of the business as a going concern.

Compensation for extinguishment of the business will be considered where there is no demonstrated intention to relocate, the intention to relocate is remote, relocation is not feasible or the business cannot be relocated.

Types of extinguishment costs

The types of costs claimable for the extinguishment of a business interest under section 59(1)(f) include, but are not limited to:

- legal costs
- valuation fees
- value of the business as a going concern
- stock losses if not included in the value of the business (and not the value of the stock on hand)
- administrative and possible penalty costs of winding up the business

Tax

Where compensation is paid for relocation it should be goods and services tax (GST) inclusive unless, because of a land owner's circumstances, an input tax credit can otherwise be claimed in relation to GST.

Compensation is payable for GST on professional fees for legal, valuation and other services that relate directly to the acquisition if an input tax credit cannot otherwise be claimed.

Where compensation is based on the extinguishment of a business interest, it will reflect the value of the business as a going concern and, consequently, there is no liability for GST.

Compensation is not adjusted for company tax or capital gains tax liabilities.

1.6 Where businesses own the acquired land

Where the land and business interest are held by the same entity and compensation for the land has been based on a higher use than the current use and the business must be forgone to realise the development potential, there may be no compensation to be determined for the business interest.

For example, the existing use value of the land is \$2 million and the business value is \$1 million, giving a total value of \$3 million. If the value of the land for redevelopment were \$5 million but the business would have to cease operation to achieve the redevelopment, the compensation would be assessed at a total of \$5 million and no business compensation given.

2 References

2.1 Definitions

sole trader A sole trader is a business entity where one individual trades, controls and manages the business. They are legally responsible for all aspects of the business and debts and losses can't be shared with other individuals.

corporations A corporation is a business entity that legally exists separately from its owner(s). The owners of a corporation are shareholders, their percentage of ownership in the business is represented by their corporate stocks or shares.

Shareholders can choose a board of directors to manage business operations, or they can create a shareholders' agreement, which will allow them to manage the business directly.

“Business compensation” The Act does not specifically refer to business compensation, but section 4 defines “land” as any interest in the land, this includes:

- a legal or equitable estate or interest in the land, or
- an easement, right, charge, power or privilege over, or in connection with, the land.

This means that a business may be considered to be an interest in land that is entitled to be compensated if it is “acquired”.

2.2 Laws and policies

Governing NSW law

Land Acquisition (Just Terms Compensation) Act 1991

Related Valuer General policy

Compensation following compulsory acquisition

Compulsory acquisition advice

Compensation following compulsory acquisition involving possible conflicts of interest

Compensation following Compulsory Acquisition of a substratum interest

Determination of compensation for disadvantage resulting from relocation

3 Context

3.1 Role of the Valuer General

The Valuer General for NSW

In NSW, the *Land Acquisition (Just Terms Compensation) Act 1991* requires that the Valuer General determine the compensation to be offered to the person entitled to compensation and any other parties having a compensable interest in the land following a compulsory acquisition of land, or an interest in land, by a state or local government authority.

The Valuer General is an independent statutory office appointed under the Valuation of Land Act 1916. The Valuer General is supported in carrying out his functions by staff of Valuation NSW under formal delegations.

A Valuation NSW valuer or private valuer contracted to Valuation NSW will prepare a valuation for recommendation of compensation by the Valuer General or his or her delegate.

The Valuer General is committed to an open and transparent valuation process that is easy for persons entitled to compensations to understand.

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Any enquiries relating to the policy may be addressed to the Valuer General of NSW at: valuergeneral@dpi.nsw.gov.au

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