

## In the Field...

# Estimation of Business Damages for Eminent Domain:

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**M**ost methods of estimating damages to a business as a result of an eminent domain action can be classified into two categories: lost profits calculation approaches, and business valuation approaches.

Lost profits calculation approaches begin with a determination of the amount of gross revenue the business will lose as a result of the condemnor's property acquisition. This determination is generally made by a marketing expert or an expert in the industry involved. This loss in gross revenue may be expressed in a percentage or dollar amount.

The reduction in gross revenue is analyzed to estimate the effect on net profit. The reduction in net profit is then converted into present value by utilizing capitalization or discounting techniques. This present value of the lost profits is considered to be the appropriate measure of business damages under these approaches.

The analyses subsequent to the determination of the loss in gross revenue are generally performed by a certified public accountant or a financial expert. Exhibit A illustrates this approach.

### EXHIBIT A

*(Lost Profits Calculation Approach)*

Gross Revenue           \$1,230,000/yr  
Loss in Gross Revenue   246,000/yr  
(20%)

Analysis is performed to arrive at:

Loss of Net Profits       16,000/yr  
Capitalization Rate       17%

Value of Lost Profits:

*(Lost Profits divided by Capitalization  
Rate)*

$\$16,000 / .17 = \$94,118$

Business valuation approaches begin with valuation of the business, before the effects of the condemnor's property acquisition. The conclusion as to this "before value" of the business is based on an analysis of qualitative and quantitative attributes of the business by a qualified business appraiser.

The next step is to perform a valuation of the business considering the effects of the condemnor's property acquisition. This valuation is analogous to the "after value" as estimated in eminent domain real estate appraising in regards to the assumption of a completed roadway improvement.

In cases where the firm is forced out of business by the effects of the property acquisition, the liquidation value of the business may be the appropriate measure of the "after value." The decrease in the value of the business ("before value" minus the "after value") is considered the

measure of business damages under these approaches. Exhibit B illustrates this approach.

### EXHIBIT B

*(Business Valuation Approach)*

Value of the Business Before the Acquisition	\$450,000
Less:	
Value of the Business After the Acquisition	<u>325,000</u>
Diminution in the Value of the Business	\$125,000

In Florida, the lost profits calculation approaches have been utilized with few exceptions. This has been true for several reasons. The major reason is that the techniques involved can be applied without the collection of voluminous detailed information concerning the subject business. In many instances this data is not available at the time of analysis as a result of an uncooperative business owner.



# Lost Profits Calculation Approaches Vs. Business Valuation Approaches

Another reason for the popularity of the lost profits calculation approaches is the lack of training and experience in valuation theory of the certified public accountants that perform the majority of business damage estimates. Accordingly, certified public accountants embrace lost profits calculation approaches because the concepts involved were adequately covered in their training as accountants. (Florida law requires that business damage estimates be performed by certified public accountants under certain circumstances.<sup>1</sup>)

The Florida courts have not restricted a showing of business damages to a particular methodology. The language in the Florida Statutes is silent as to what constitutes business damages and the courts have been hesitant to restrict elements of such damages. Accordingly, the court decisions generally allow a variety of methodologies which purport to show damages resulting to a business because of the taking for road purposes.<sup>2</sup>

The use of business valuation approaches has many advantages over the use of lost profits calculation approaches for the estimation of business damages in eminent domain. The results of a business valuation analysis contain "benchmark" conclusions which lead to the final conclusion of business damages. These "benchmarks" include the value of the business, the value of the business goodwill, the value of the net tangible assets, and the value of the intangible assets (other than goodwill).

These fundamental conclusions tend to provide support for the analysis and insures that the final conclusion is related to the economic reality of the operating business. In contrast, the lost profit calculation approaches are driven by a mathe-

matical operation (capitalization or discounting to present value) and may be oblivious to the reality of the economic relationships involved.

An additional advantage of using the business valuation approaches is that both a body of knowledge and an established field of practitioners currently exist. Lost profit calculation approaches do not enjoy this stabilizing influence.

Business valuation approaches parallels real estate appraisal approaches in theory and in application to eminent domain. This is beneficial in that the courts, the practitioners, and the laymen involved in the eminent domain process are able to

understand this type of business damage estimation by relating it to the real estate appraisal concepts.

In summary, the business valuation approaches to estimating business damages in eminent domain have many practical advantages over the lost profit calculation approaches. Taxpayers and business owners alike will be greatly benefited by implementation of business valuation analysis.

#### References:

1. Florida Statutes Ch. 337.271(5)
2. Matthews v. D.O.T., 324 So2nd 664 (Fla. 4th DCA 1975)  
Mulkey v. D.O.T., 448 So2nd 1062 (Fla. 2nd DCA 1984)

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