

**VICTORIAN CIVIL AND ADMINISTRATIVE TRIBUNAL
ADMINISTRATIVE DIVISION**

**PLANNING AND ENVIRONMENT LIST
(LAND VALUATION)**

VCAT REFERENCE NO. P727/2017

APPLICANT	ISPT Pty Ltd
VALUATION AUTHORITY	Melbourne City Council
INTERVENOR & JOINED PARTY	Valuer General Victoria
LAND	338 - 352 Bourke Street Melbourne (former Melbourne GPO)
WHERE HELD	Melbourne
BEFORE	Mark Dwyer, Deputy President Justine Jacono, Senior Member
HEARING TYPE	Hearing
DATES OF HEARING	28 & 29 May, 30 & 31 July, 2 August, and 9 October 2018
DATE OF ORDER	18 December 2018
CITATION	ISPT Pty Ltd v Melbourne CC & Valuer General Victoria [2018] VCAT 1647

ORDER

- 1 The decision of the valuation authority is set aside in relation to site value.
- 2 The valuation of the site value of the land at 338 - 352 Bourke Street Melbourne as at **1 January 2016** is substituted to be as follows:

Site Value	\$1
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- 3 Any party that wishes to apply for costs must file with VCAT and serve on the other party its application and supporting submission by no later than **28 March 2019**. If no party has made a costs application by that date, each party is to bear its own costs.

Mark Dwyer
Deputy President

Justine Jacono
Senior Member



APPEARANCES

For ISPT Pty Ltd	David Batt QC & Dr Charles Parkinson of counsel, instructed by Gadens Lawyers. They called the following witnesses: <ul style="list-style-type: none">• Amanda Ring, town planner• Les Brown, valuer
For Valuer General Victoria	Paul Connor QC & Lisa Hannon of counsel, instructed by Jerome Collopy, Land Use Victoria Legal. They called the following witness: <ul style="list-style-type: none">• Karl Cundall, valuer
For Melbourne CC	No appearance. The Council subrogated its interests in the site value assessment to the Valuer General.

INFORMATION SCHEDULE

Nature of proceeding	Application under s 22 of the <i>Valuation of Land Act 1960</i> – to review the site value of the land as at the relevant valuation date of 1 January 2016.
Land description	<p>The land at 338 - 352 Bourke Street, Melbourne is located at the north-east corner of Bourke and Elizabeth Streets, Melbourne.</p> <p>The land is comprised in Certificate of Title Volume 10787 Folio 815, being the land in Plan of Consolidation 366537A. It is a roughly rectangular lot of approximately 3,865 m², with a frontage to the Bourke Street Mall of 40.09 m, and a frontage to Elizabeth Street of 96.43 m.</p> <p>The land contains the Melbourne GPO building, dating from the 1860s, which is registered on the Victorian Heritage Register (VHR No. H0903).</p> <p>The building and land was redeveloped in 2004 as a multi-level retail/commercial centre. The building has a net lettable area of 8,178 m².</p>
Tribunal inspection	28 May 2018 (accompanied by the parties' legal representatives). The inspection was facilitated by Rob Pratt of JLL Property & Asset Management.



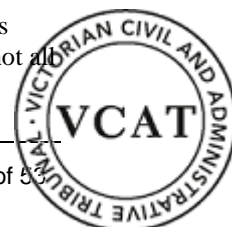
REASONS¹

WHAT IS THIS PROCEEDING ABOUT?

Introduction

- 1 This proceeding concerns the site value of the land on the corner of Elizabeth Street and the Bourke Street Mall, which contains the Melbourne GPO building. The relevant valuation date is 1 January 2016.
- 2 The site value of land is ordinarily assessed under the *Valuation of Land Act 1960 (VL Act)* on the basis that any improvements to the land had not been made. However, the Melbourne GPO is listed on the Victorian Heritage Register, and is subject to s 2(8) of the VL Act – a special provision that governs the valuation of land that includes a heritage-registered building.
- 3 By way of background:
 - The valuation authority, Melbourne City Council (**Council**), assessed the site value at \$14,800,850 as at the relevant valuation date.
 - The occupier of the land, ISPT Pty Ltd (**ISPT**), objected to the assessment. It contended for a nominal site value of \$1 due to the heritage restrictions affecting the land.
 - Following a deemed disallowance of the objection, ISPT has made application to VCAT to review the site value.
 - At the hearing, ISPT still contended for a nominal site value of \$1 based on the evidence of the valuer Les Brown. Mr Brown's primary method of valuation was a hypothetical development approach (**Brown Valuation #1**). He also used two check methods - a capital improved value less depreciated value of improvements (**Brown Valuation #2**) and a capital improved value less replacement cost of improvements (**Brown Valuation #3**) that led to a similar outcome.
 - The Valuer General Victoria (**Valuer General**) intervened in the proceeding and was joined as a party. The Valuer General contends for a site value of \$29,100,000, based on the evidence of the valuer Karl Cundall. Mr Cundall's primary method of valuation was a rent differential approach (**Cundall Valuation #1**).
 - At the hearing, the Valuer General also relied on an alternative valuation by Mr Cundall, with a contended site value of \$26,400,000, later revised to \$26,375,000 (**Cundall Valuation #2**).
 - Following the intervention of the Valuer General, the Council subrogated its interests in the site value assessment to the Valuer General, and the Council did not participate at the hearing.

¹ The submissions and evidence of the parties, and all other material filed in the proceeding, has been considered in the determination of the proceeding. In accordance with VCAT practice, not all of this material is referred to separately in these reasons.



- 4 The capital improved value of the land is not contested. It was assessed by the Council at \$71,334,000 as at the relevant valuation date.
- 5 The wide disparity in the assessments of site value arise because:
 - the parties disagree about how s 2(8) of the VL Act should be interpreted in the context of this valuation; and
 - the valuation approaches used by the valuers are very different.
- 6 These are the two matters directly in contest in the proceeding.

Why does the site value matter?

- 7 The statutory assessment of site value under the VL Act is used in Victoria for the assessment of land tax.
- 8 Section 2(8) of the VL Act contains a series of assumptions arising from the existence of a heritage-registered building, which ostensibly allow for an artificially reduced site value compared to the unaffected market value that would otherwise arise if the land was not heritage constrained. This leads to a consequential reduction in land tax to the owner of the heritage affected land.
- 9 The policy rationale for s 2(8) is clear. The reduced land tax reflects the community benefit achieved through the heritage protection of the building, and the potential impediment to the land owner arising from higher maintenance costs and/or restrictions on development or use associated with the heritage registration.
- 10 However, the Melbourne GPO is now adapted and used for office and retail purposes, with the 'H&M' retail store as its anchor tenant. The land is well located in the retail core of the Melbourne CBD and achieves a solid commercial return for its owners.
- 11 The successful use of a heritage-registered building in this way has led to some debate about how s 2(8) of the VL Act should be interpreted, and the valuation approaches that best reflect the way in which the heritage constraint really affects the underlying value of a heritage-registered site.
- 12 In NSW, for example, there has been some support for a valuation approach that applies a formula based on the rental differential or return achieved from the heritage-affected land as compared to the commercial return that would otherwise be achieved if the land was not heritage constrained.
- 13 Adopting this approach in Victoria, a commercially successful heritage building would therefore theoretically have higher rents and a correspondingly smaller rent differential (when compared to an unencumbered building), a higher value, and accordingly pay more land tax. There is no doubt that the Valuer General's intervention in this proceeding, and its support for a variant of the NSW rental differential valuation approach, is predicated on this basis.



- 14 However, whilst land tax forms the backdrop to this proceeding, it is not of direct concern to us. On a review of a site value assessment under the VL Act, we are simply concerned with the proper interpretation and application of the VL Act, including s 2(8), and the different assumptions and methodologies used by the valuers by reference to this provision. Our obligation on review is to consider the evidence before us and to determine the correct or preferable site value for the land.
- 15 We have nonetheless made some observations on the desirability for reform or clarification of s 2(8) of the VL Act at the end of our decision.

What the proceeding is not about

- 16 We consider that this matter turns very much on its own facts and circumstances and should not be relied upon as a general statement of principle as to how a heritage-registered property must be valued. We would caution those in the valuation industry who seek to treat this proceeding as a test case in this regard.
- 17 Clearly, the VL Act does not prescribe any particular method of valuation. Different methods of valuation may be applied in different circumstances to ascertain the correct or preferred valuation of land. Consequently, our decision does not purport to prefer or dictate a single methodology to assess the site value of land containing a heritage-registered building.
- 18 Moreover, this is not a case relating to s 2(9) of the VL Act or heritage-affected land generally, such as land subject to a heritage overlay under a planning scheme. It is relevant only in relation to land and/or a building on the Victorian Heritage Register, where s 2(8) of the VL Act applies. It is also an unusual case where all three parts of s 2(8)(a), (b) and (c) of the VL Act come in to play, and where the capital improved value (CIV) is not contested or open to scrutiny, which may conceivably lead to a different approach and outcome.
- 19 In preferring Mr Brown's valuation, this should not be taken as an endorsement of a hypothetical development model *generally* for the valuation of buildings or land on the Victorian Heritage Register, nor a dis-endorsement of the possible use of a rent differential method of valuation. It is simply the case that, based on the evidence before us in this proceeding, we have found Mr Cundall's very specific approach to be flawed, and we have found Mr Brown's approach to provide an acceptable and 'preferred' valuation outcome.

THE MELBOURNE GPO

Registration on the Victorian Heritage Register

- 20 The Melbourne GPO building occupies a large part of the land. The building dates from the 1860s, and is recognised for its historical, architectural and social significance. It is also the point from which distances from Melbourne to other Victorian centres are measured.

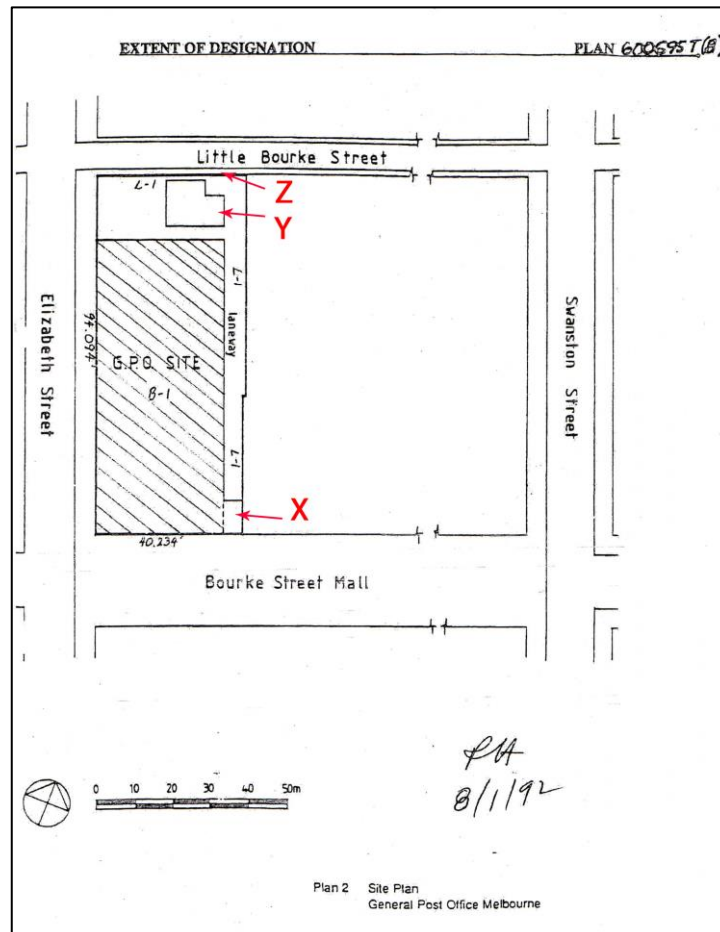


- 21 The Melbourne GPO is listed on the Register of the National Estate and, importantly for this proceeding, it is also included on the Victorian Heritage Register. The registration and listing on the Victorian Heritage Register was gazetted in 1992², with the extent of designation described in the Victorian Heritage Database as follows:

Historic Building No. 903:

General Post Office, Bourke Street, Melbourne

1. The building known as the General Post Office, Melbourne, shown marked B-1 on Plan 600695T(B), endorsed by the Chairperson, Historic Buildings Council and held by the Director, Historic Buildings Council.
 2. All the land described in Certificate of Title Volume 9699 Folio 119 shown marked L-1 on Plan 600695T(B).
- 22 The referenced Plan 600695T(B) is set out below (**VHR Plan**), with the annotations 'X', 'Y' and 'Z' (inclusive) added by us.



- 23 From the evidence, the parties agree that:

- The shaded area marked B-1 on the VHR Plan and noted as 'GPO site' comprises the Melbourne GPO building. It is the land referenced in the first paragraph of the heritage registration³.

² Victoria Government Gazette No. G3 22 January 1992 p.151

³ Cundall has calculated the B-1 area as 2,795 m², and Brown as 2,770 m² (a variance of 25 m²).

- The area marked L-1 on the VHR Plan comprises land that, at the time of registration, was included in Certificate of Title Volume 9699 Folio 119. It is the land referenced in the second paragraph of the heritage registration⁴.
- The small area we have annotated 'X' on the VHR Plan is anomalous. It comprises the area of the lower tower at the eastern end of the Bourke Street façade⁵, through which there is a ground-level portal to the laneway behind, as indicated below.



This tower is clearly part of the 19th century building, although apparently altered in the late 1800s. It is not shaded as part of the area marked B-1 on the VHR Plan, but it is separated from that area only by a broken (rather than fixed) line. There is nothing in the documents forming part of the heritage registration that clearly identifies whether this area was to be excluded from the registration.

- The areas we have annotated 'Y' and 'Z' on the VHR Plan are not marked as B-1 or L-1 on the VHR Plan and do not form part of the heritage registration. The area marked 'Y' comprised a contemporary 'philatelic sales' building that existed at the time of the heritage registration, but which was excised from the registered area. The area marked 'Z' is a 1.46m strip of land fronting Little Bourke Street that was in a different title at the time of the heritage registration.
- 24 Since the initial registration of the Melbourne GPO on the Victorian Heritage Register in 1992, the land titles have been consolidated. The land is now in Certificate of Title Volume 10787 Folio 815, which is the land subject to the disputed valuation in this proceeding⁶. The heritage registration is clearly referenced on this consolidated title.
- 25 The original heritage registration occurred under the former *Historic Buildings Act 1981*. The parties agree that, by reference to relevant transitional provisions, the Melbourne GPO has maintained its registration

⁴ Cundall has calculated the L-1 area as 1,019 m², and Brown as 988 m² (a variance of 31 m²).

⁵ Both Cundall and Brown have calculated this area as 42 m².

⁶ This is essentially a consolidation of the title referred to in the heritage registration (Volume 9699 Folio 119), and the title to the strip of land we have annotated 'Z' on the VHR Plan (Volume 8659 Folio 477)

on the Victorian Heritage Register under the *Heritage Act 1995* (which was in force at the relevant valuation date) and under the *Heritage Act 2017*.

Built form and use as at 1 January 2016

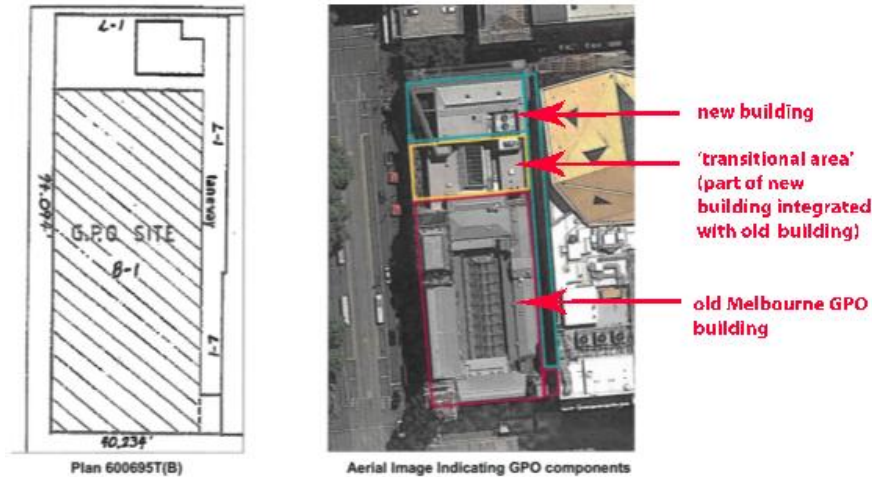
- 26 The land containing the Melbourne GPO is located at the north-east corner of Bourke and Elizabeth Streets, Melbourne. The Melbourne GPO thus occupies one of the prime retail sites in the centre of the Melbourne CBD.
- 27 Postal functions ceased on the site in or around 2001. Although we understand that Australia Post still owns the building, the site was then let to developers. Following a fire in September 2001 (to which we will refer later), the building was restored and partially redeveloped into a multi-level retail shopping centre that opened in 2004. The redevelopment occurred in accordance with a permit granted by the Heritage Council⁷.
- 28 ISPT acquired its interest in the Melbourne GPO in 2005, as the head leaseholder. The retail shopping centre was later converted into a single tenancy, and the major tenant H&M opened its store there in 2014. H&M occupies over 5,000 m² of lettable area (including retail, storage and office accommodation) across all levels of the building. The remainder of the building is tenanted by six specialty tenants and two commercial tenants, who collectively occupy a lettable area of 3,187 m² ⁸.
- 29 The image below shows the Elizabeth Street elevation. The image was not taken on the relevant valuation date of 1 January 2016 but is representative of the development and use at that time. The view from this aspect is useful because it shows the extent of the redevelopment at the rear of the site, fronting Little Bourke Street. It also shows the transitional area where the modern building sits within and above the rear of the historic building.



⁷ VHC Permit P6286, Tribunal Book 1295

⁸ Brown's evidence is that there is a total lettable area of 8,178 m², within a total building area of 12,481 m². (The total building area is made up of 9,616 m² in the old building, and 2,865 m² in the new building).

- 30 As will be seen, we consider that the integration between the old and new buildings, and the extent of shared services between the two buildings is of some relevance to its valuation. When the new development is compared to the area of the heritage registration, this integration and overlap is also apparent, as indicated below.



- 31 The 'transitional area' is within the area marked B-1 on the VHR Plan and contains part of the old Melbourne GPO building, and part of the new building, and includes a range of shared services to both areas.
- 32 Apart from the built areas, the laneway forming part of the area marked L-1 on the VHR Plan (which covers an old easement) is now also leased and used for commercial purposes, for cafes and restaurants. There is again a level of integration within the overall site, with shared services and kitchen areas for the café/restaurants in the basement of the Melbourne GPO building.



THE COUNCIL'S VALUATION

The decision under review

- 33 As we have indicated, the Council (in its capacity as valuation authority) assessed the site value at \$14,800,850 as at the relevant valuation date of 1 January 2016.
- 34 This is the underlying decision that is technically the subject of this 'review' proceeding. ISPT's core ground of review is that the value



assigned to the site value is too high - being an available ground for objection and review, having regard to s 17(a) of the VL Act.

- 35 In a Council letter to ISPT that provided the prescribed information required under s 20 of the VL Act, as a preliminary to the objection process⁹, the Council indicated that:

The applied valuation methodology to derive site value has been to work back from the assessed Capital Improved Value, deducting the added value of improvements to arrive at site value.

- 36 We note that this is a broadly similar approach to one of Mr Brown's check methods, albeit based on quite different inputs for calculating the added value of improvements.
- 37 On the figures used in the Council letter, the Council derived the site value as being the assessed CIV of \$71,565,000 less the added value of improvements of \$56,723,180, giving a site value of \$14,841,820 (rounded to \$14,840,000). Subsequent minor adjustments to these figures led to a CIV of \$71,334,000 and the adopted site value of \$14,800,850.
- 38 The Council letter sets out the basis upon which the 'added value of improvements' of \$56,723,180 is calculated, although it is unnecessary to detail that here. Essentially, the Council had calculated this amount by reference to hypothetically reconstructing the existing building. The Council letter noted that it had relied only upon sample quantity surveyors' reports of various properties that the Council had obtained replacement costs estimates for, Council's own construction costs for various construction projects, and the Rawlinson's Australian Construction Handbook 2016.

Previous site values

- 39 ISPT's valuer Mr Brown provided us for comparative purposes with the levels of value returned by the Council for the land as at the relevant date, and for the three previous assessments.

Valuation Date	Land Area	Capital Improved Value	Net Annual Value	Site Value	Site Value Analysis
01-Jan-10	3,856 m ²	\$76,800,000	\$4,865,000	\$1,600,000	\$415 /m ²
01-Jan-12	3,856 m ²	\$78,600,000	\$5,561,000	\$1,930,000	\$501 /m ²
01-Jan-14	3,856 m ²	\$71,850,000	\$4,125,900	\$1,935,200	\$502 /m ²
01-Jan-16	3,856 m ²	\$71,334,000	\$4,108,300	\$14,800,850	\$3,838 /m ²

- 40 It can be seen that the CIV and NAV have remained within a broadly similar range over this period. However, the significantly increased site value assessment as at 1 January 2016 appears anomalous when compared with the previous three site value assessments, particularly given:

⁹ Letter dated 29 November 2016 from Pauline Lawson, valuations manager for the City of Melbourne, to Grant Jackson of M3 Property (ISPT's valuers), handed up during the hearing.



- the site did not materially change;
 - there was no movement in the Melbourne CBD retail and office market, or the property market generally, to explain the extent of the change; and
 - s 2(8) of the VL Act applied during the entire period.
- 41 Equally, ISPT's now contended site value of \$1 and the Valuer General's contended site values of \$26,400,000 or \$29,100,000 as at 1 January 2016 are also anomalous when compared to the site values assessed in the previous periods.
- 42 For practical purposes, little turns on these anomalies given the different valuation methodologies before us in this proceeding.

The status of the Council decision

- 43 By reference to s 51 of the *Victorian Civil and Administrative Tribunal Act 1998*, in a review proceeding, we can (amongst other things) affirm or vary the decision under review, or set aside the decision under review and make another decision in substitution for it.
- 44 We consider at a threshold level that the Council decision should be set aside, rather than affirmed or varied. This is because:
- Although technically a party in the proceeding, the Council did not participate at the hearing to 'defend' its assessment of site value. It subrogated its interests to the Valuer General who, equally, did not seek to support or defend the Council valuation.
 - We have no evidentiary basis to use as a starting point for affirming or varying the Council decision, save for the Council letter referred to above. Whilst ISPT and the Valuer General disagreed on many things, one matter upon which they were agreed was that the information and estimates used for Council's calculation of the 'added value of improvements' of \$56,723,180, to derive the site value, was flawed and unreliable.
 - We were informed that the three previous site value assessments were based on an 'agreed' position in 2010 that was not reflective of any of the valuation methodologies now contested in this proceeding, and that the 2010 site value was then simply adjusted for 2012 and 2014. These previous site value assessments are therefore of no assistance to us in reviewing the Council's 2016 decision¹⁰.
 - Neither ISPT nor the Valuer General sought to use the Council's assessment of site value as a basis for their respective submissions and evidence. Both advocated for entirely different approaches to the

¹⁰ In any event, whilst a previously assessed value *may* be a relevant consideration, for comparative purposes, in a subsequent valuation exercise, we are not bound by any previous assessment or valuation approach.



calculation of site value. Indeed, on at least one of the Valuer General's arguments, the approach adopted by the Council would be legally impermissible as a primary method of valuation¹¹.

- In a review proceeding, there is no ultimate onus on the applicant to satisfy VCAT that the specific decision under review (i.e. the Council decision) was wrong. Once an objection is raised to a valuation, and the question of site value is before VCAT, the persuasive burden simply falls upon each party to establish its contended value¹². Here, the original Council decision is not relevant to that task.

45 Accordingly, the Council decision under review should properly be set aside, and we should consider what is the correct or preferable site value to be substituted in its place. That was essentially the approach adopted by ISPT and the Valuer General.

46 The consequence of this is that we must consider the site value as at 1 January 2016 afresh, based on the submissions and evidence before us.

47 In any event, as will be seen, we have preferred the Brown Valuation #1. This means ISPT's ground of review is made out in that the Council's site value is 'too high'. This again supports the position that the Council decision should be set aside, with a new decision substituted in relation to site value.

48 We do not therefore propose to comment further on the Council decision.

THE CONTESTED VALUATION APPROACHES

49 As we indicated in our opening comments, the VL Act does not directly prescribe any method of valuation. Although an expert tribunal, VCAT cannot itself value the land. The valuation approach adopted in a particular case may therefore depend on the evidence before the tribunal in that case.

50 Both valuers indicated that their primary approach to the assessment of site value would ordinarily be to consider comparable sales evidence. However, as both valuers conceded, as a matter of logic there can be no *vacant* land sales of a heritage-registered *building*. The unique requirements of s 2(8) of the VLA and the Melbourne GPO site result in there being no comparable sales evidence.

51 Whilst we will deal with the main contested valuation approaches throughout these reasons, it is useful to first describe these main approaches in summary form. Given the unusual characteristics of the Melbourne GPO site, it will soon become apparent that none of the methods are necessarily 'ideal' for the valuation of this land. However, in the absence of direct comparable sales evidence, the use of some form of theoretical valuation method is necessary.

¹¹ i.e. as being inconsistent with the principle in *Tooheys*, a matter we discuss later in these reasons.

¹² generally following *Challenger Asset Management Pty Ltd v Stonnington CC* (2011) 34 VR 445.



Brown valuation #1

52 The Brown Valuation #1 is based on a relatively orthodox hypothetical development approach, which leads to an assessed site value as at the relevant date of 1 January 2016 of a nominal \$1. The main steps are as follows¹³:

- Step 1 - Determine the gross realisation.
(Gross rent \$6,685,133 less outgoings \$1,828,100 = \$4,857,033, capitalised at 4.5% = \$107,934,060. This is adjusted for capital expenditure (including heritage capital expenditure) calculated at \$6,870,076 to give an indicated investment value of \$101,063,984, rounded to \$101 million)
- Step 2 – Deduct the selling costs.
(\$101 million less selling costs @ 1.65% (\$1,666,500) = \$99,333,500)
- Step 3 – Deduct the profit and risk factor.
(Net realisation (\$99,333,500) less profit and risk @ 15% (\$12,974,468) = \$86,359,032)
- Step 4 – Deduct cost of hypothetical development, holding costs, interest and adjustments for taxes, to give indicated value (inclusive of GST). Here, by reference to the assumptions in s 2(8) of the VL Act, Mr Brown equates his ‘hypothetical development’ to the existing improvements.
(development cost = \$315,571,300¹⁴, adjusted for interest and holding costs and GST inputs = \$314,326,322.
\$86,359,032 less \$314,326,322 = minus \$227,967,290)
- Step 5 – Adjust for GST to give indicated value (exclusive of GST).
(adjust GST of \$20,724,299 from minus \$227,967,290 = minus \$207,242,991, rounded to minus \$207,250,000)

53 As the indicated value is negative, a nominal value of \$1 is applied.

Brown Valuation #2 and Brown Valuation #3

54 As we have indicated, Mr Brown also uses two check methods. Both are based on an assessed capital improved value of \$81,500,000, derived from gross rents less outgoings, capitalised at 5.5%, and adjusted for capital expenditure.

¹³ We have not detailed all of the adjustments in this summary of the valuation approach. All relevant adjustments are set out in Mr Brown's report.

¹⁴ This is based on the quantity surveyor evidence of Mr Grimes, to which we will refer, indicating development costs (exclusive of GST) of \$286,883,000 which, adjusted for GST, is \$315,571,300.



- 55 A key difference between Mr Brown's assessment of investment value¹⁵ and the CIV lies in his applied capitalisation rates of 4.5% and 5.5% respectively. The lower or 'softer' capitalisation rate of 5.5% used to assess CIV is due to Mr Brown's application of the definition of CIV that requires the existing leases to be ignored¹⁶.
- 56 The two check methods are then applied as follows¹⁷:
- Brown Valuation #2 – CIV less depreciated value of development
(value of existing improvements, depreciated at 40% for heritage building and 15% for new building = \$176,358,550, deducted from CIV of \$81,500,000 and rounded = minus \$94,860,000)
 - Brown Valuation #3 – CIV less replacement cost of improvements
(replacement cost of existing improvements = \$286,883,000, deducted from CIV of \$81,500,000 and rounded = minus \$205,380,000)
- 57 Again, as the indicated values are both negative, a nominal value of \$1 is applied.

Cundall Valuation #1

- 58 The Cundall Valuation #1 is based on a rent differential approach and leads to an assessed site value as at the relevant date of 1 January 2016 of \$29,100,000.
- 59 Under cross-examination, Mr Cundall conceded that his method was not known to be used or accepted in Victoria or elsewhere.
- 60 The main steps in the Cundall Valuation #1 are as follows:
- Step 1 – Calculate the unencumbered site value.
(3,856 m² @ \$22,000/m² = \$84,832,000)
 - Step 2 – Calculate the net market rent of existing land and improvements.
(Gross rent \$7,216,757 less outgoings \$2,040,654 = \$5,176,103 rounded to \$5,175,000)
 - Step 3 – Calculate the net market rent of the hypothetical highest and best use of the land and potential improvements¹⁸.
(Gross rent \$20,096,250 less outgoings \$5,010,750 = \$15,085,500 rounded to \$15,085,000)

¹⁵ i.e. the rate used in determining the gross realisation in Step 1 of the Brown Valuation #1

¹⁶ Mr Brown also considered that the capitalisation rate of 5.5% used to assess CIV was consistent with the analysed market yields from his limited but relevant sales evidence (including the Block Arcade) in the range 5.3% to 5.9%.

¹⁷ Again, all relevant adjustments are detailed in Mr Brown's report.

¹⁸ Mr Cundall based his highest and best use on a theoretical building of 32,000 m², a matter we discuss later in these reasons.



- Step 4 – Calculate the Rental Differential Ratio of the existing use compared to the hypothetical highest and best use.
 $(\$5,175,000/\$15,085,000=34.31\%)$
- Step 5 – Apply the Rental Differential Ratio to the unencumbered site value to derive the Heritage Registered Encumbered Site Value
 $(\$84,832,000 * 34.31\%=\$29,105,859, \text{ rounded to } \$29,100,000)$

61 At the hearing, Mr Cundall provided an amended spreadsheet, with Step 2 adjusted to adopt ISPT's figures for market rents. This leads to a Rent Differential Ratio being derived under Step 4 of 32.19% and a Heritage Registered Encumbered Site Value derived under step 5 of \$27,314,008, rounded to \$27,300,000.

Cundall Valuation #2

62 The Cundall Valuation #2 was tendered at the hearing, and later revised¹⁹. Our comments here are based on the revised version. It is not a variation of the Cundall Valuation #1, but a different approach, based on an attempt to deal with different parts of the land separately in order to give effect to different assumptions in s 2(8)(a),(b) and (c) of the VL Act. It leads to an assessed site value as at the relevant date of 1 January 2016 of \$26,375,000.

63 The Cundall Valuation #2 is therefore a piecemeal approach that proceeds on the assumptions that:

- The B-1 land (and the area we have annotated X on the VHR Plan), together totalling 2,837 m²) will remain vacant and have no improvements but could be used as an open-air market in order to maintain its retail/commercial use.
- The rear of the L-1 land is used for the construction of a stand-alone 3-4 storey development of 2,865 m². A forecourt area for outdoor dining could be on part of the B-1 land if associated with a restaurant/café use in the building. The L-1 laneway is treated similarly to B-1.

64 For the B-1 land and the land annotated X on the VHR Plan, Mr Cundall analysed a small number of comparable sales, and adopted an underlying land rate of \$25,000/m². To this he applied a 90% adjustment, having regard to his assumption of a permanent lack of development, giving an adjusted rate of \$2,500/m². This is multiplied with the land area of 2,837 m² to provide a derived en globo value for this part of the land of \$7,092,500²⁰.

¹⁹ The initial Cundall Valuation #2 is in a letter dated 28 May 2018 (TB 1260), revised and updated on 26 July 2018. We have not detailed all of the adjustments in this summary of the Cundall Valuation #2. The relevant adjustments are set out in Mr Cundall's report.

²⁰ In Mr Cundall's revised letter of 26 July 2018, he refers incorrectly to a figure of \$7,027,500 for this item. The figure of \$7,092,500 that we have referred to appears in an accompanying spreadsheet and is mathematically correct.



- 65 For the L-1 land, a hypothetical development approach is used. The gross development area of 2,865 m² has been adjusted by 15% to calculate a net lettable area (NLA) of 2,435 m² for the rear L-1 land. A gross realisation of \$51,700,000 is derived from an assumed net market rent of \$2,585,000 (inclusive of a ground rental for the L-1 lane), capitalised at 5%. After allowing for selling costs (\$1,034,000), profit and risk at 15% (\$6,608,609), construction and holding costs (\$19,378,383), and purchase costs (\$5,398,526), a derived en globo value for this part of the land is \$19,280,482.
- 66 Adding the values for the two parts of the land, the total site value is assessed at \$7,092,500 + \$19,280,482 = \$26,372,982, rounded to \$26,375,000.

SECTION 2(8) OF THE VALUATION OF LAND ACT 1960

- 67 We turn now to the governing legislation that lies at the heart of the dispute in this proceeding.
- 68 As at the relevant date of 1 January 2106, s 2(8) of the VL Act provided as follows:

- (8) Despite anything in this Act, the *Local Government Act 1989* or the *Fire Services Property Levy Act 2012*, the capital improved value, net annual value and site value of any rateable land, non-rateable leviable land or non-rateable non-leviable land which is a registered place within the meaning of the *Heritage Act 1995* or on which there is situated a building which is included in the Heritage Register established under that Act must be calculated on the basis—
- (a) as to the part actually occupied by the building included in the Heritage Register established under the *Heritage Act 1995*—
- (i) that the land may be used only for the purpose for which it was used at the date of valuation; and
- (ii) that all improvements on that land as at the date of valuation may be continued and maintained in order that the use of the land referred to in subparagraph (i) may be continued; and
- (iii) that no improvements, other than those referred to in subparagraph (ii), may be made to or on that land; or
- (b) as to any part (not actually occupied by the building which is included in the Heritage Register and which is not land that is included in the Heritage Register) that the building which is included in the Heritage Register cannot be removed or demolished and that any land referred to in paragraph (c) must not be subdivided or developed unless a permit to subdivide or develop the land has been granted by the Heritage Council; or
- (c) as to any land that is included in the Heritage Register established under the *Heritage Act 1995* that the land cannot be subdivided or developed or if a permit to subdivide or develop the land has been granted by the Heritage Council, that it can be subdivided or developed only in accordance with that permit.



- 69 There is no difference between this version of s 2(8) of the VL Act (as at 1 January 2016) and the current version, save that the current version now refers to the *Heritage Act 2017*.
- 70 What can be seen is that s 2(8) requires that the site value of land on which there is a building on the Victorian Heritage Register (i.e. here, the Melbourne GPO) must be calculated by reference to the physical attributes of certain parts of the land.

What parts of s 2(8) apply in this proceeding?

- 71 By reference to the VHR Plan, the parties are now agreed that:
- The area marked B-1 on the VHR Plan falls within s 2(8)(a).
 - The area marked L-1 on the VHR Plan falls within s 2(8)(c).
 - The area we have annotated 'X' on the VHR Plan appears to technically fall within s 2(8)(b) but, for practical valuation purposes, it should be included as part of the heritage building falling within s 2(8)(a)²¹.
 - The areas we have annotated 'Y' and 'Z' on the VHR Plan fall within s 2(8)(b).
- 72 As can be seen, the application of different parts of s 2(8) of the VL Act to different components of the Melbourne GPO site adds yet a further layer of complexity to its valuation.
- 73 Unfortunately, the different parts of s 2(8) of the VL Act were not understood when either Mr Cundall or Mr Brown prepared their initial valuations. The Brown Valuation #1 and Cundall Valuation #1 had been prepared generally by reference only to the assumptions in s 2(8)(a).
- 74 This is why, on the second day of hearing, the Valuer General tendered the Cundall Valuation #2, which purported to expressly take into account the different parts of s 2(8)(a), (b) and (c) of the VL Act. This led to an adjournment to allow ISPT to respond.
- 75 Shortly before the resumed hearing, ISPT tendered a further report from Mr Brown. Mr Brown did not prepare a further valuation considering the different parts of s 2(8)(a), (b) and (c), but instead:
- indicated that, in now having regard to s 2(8)(a), (b) and (c) of the VL Act, his primary method of valuation (i.e. the hypothetical development approach) and his two check methods, and the outcome of the valuation (i.e. a nominal site value of \$1) would remain unchanged; and
 - provided a critique of the Cundall Valuation #2.

²¹ The town planner Amanda Ring agreed in evidence that the omission of this area from the VHR Plan was probably an error.



How should s 2(8) of the VL Act be interpreted?

- 76 We have already referred in general terms to the intent of s 2(8) of the VL Act. It contains a series of assumptions arising from the existence of a heritage-registered building, which allow for an artificially reduced valuation compared to the unaffected market value that would otherwise arise if the land was not heritage affected. It is a mechanism, albeit an indirect and cumbersome one, intended to reduce the statutory valuation-based rates and taxes that would otherwise apply to land upon which there is a heritage-registered building.
- 77 There was no material difference between the parties concerning this underlying legislative intent, but the actual interpretation and application of s 2(8) – and, in particular, s 2(8)(a)(ii) – is one of the key issues in dispute. It is fair to reflect that s 2(8) is inelegantly drafted by modern standards, and this adds to the difficulties in its interpretation and application.
- 78 We make the following initial comments about s 2(8):
- Stripped of wording superfluous to this proceeding, the opening part of s 2(8) provides that, despite anything in the VL Act, the site value of any rateable land upon which there is a building included in the Victorian Heritage Register must be calculated on the basis set out in the balance of the sub-section.
 - The opening words ‘*Despite anything in this Act*’ (i.e. the VL Act) are important. To the extent of any express or implied inconsistency between s 2(8) and another provision of the VL Act, s 2(8) should prevail²². For example, s 2(8)(a)(i) requires an assumption to be made that the relevant part of the land may be used only for the purpose for which it was used at the date of valuation. This is inconsistent with and overrides s 5A(3)(a) of the VL Act, which would otherwise require the land to be valued having regard to its highest and best use (which may be a potential use, rather than the existing use).
 - Notwithstanding this, other provisions of the VL Act can continue to apply to the valuation of land affected by s 2(8) where there is no express or implied inconsistency. For example, the parties were generally agreed that the definitions of ‘site value’ and ‘improvements’ in s 2(1) of the VL Act continue to apply.
 - Section 2(8) must be interpreted having regard to the fact that the provision deals with the potential calculation of capital improved value, net annual value and site value. We agree with ISPT that the language employed in the provision must be capable of responding to each of these three valuation scenarios, even when only site value is in dispute.

²² This was confirmed in the decision of the Court of Appeal in *Australian Postal Commission v Melbourne City Council* [2005] VSCA 295, concerning an earlier valuation of the very same land.



- 79 Section 2(8) requires the valuation to be calculated on the basis set out in sub-paragraphs (a), (b) and (c), and these sub-paragraphs refer to different parts of the land. However, this does not necessarily lead to a scenario whereby the three parts of the land falling under s 2(8)(a), (b) and (c) are each valued quite separately, and then aggregated. The valuation exercise is ultimately to determine the site value of the land as a whole. Whilst it is necessary for a valuer to correctly apply the relevant statutory assumptions in the relevant parts of s 2(8) to relevant parts of the land, the valuer can still properly have regard to the inter-relationship between the various parts of the land in the assessment of the overall site value. The only proviso of course is that this task cannot be undertaken in a manner inconsistent with any of those statutory assumptions.
- 80 The consequence of this is reflected here in three main ways:
- As we have indicated, there are a range of shared services and infrastructure between different parts of the buildings and land that *may* be relevant to the development or use of the land.
 - The Heritage Council permit essentially relates to an integrated development for the whole of the land and is linked to endorsed plans for the whole of the land, and the development cannot easily be severed between different parts of the land. As ISPT noted, the development on the L-1 land, if considered and valued separately²³, would have no southern facade, incomplete services, and no stair access.
 - For the parts of the land that do not contain the heritage-registered building, it remains relevant that these areas form part of a larger parcel of land which is affected by the heritage registration, and which *may* therefore create some impediment to their development or use.
- 81 Whilst we will deal with a couple of the key issues in dispute in more detail later in these reasons, we make the following initial comments about sub-sections 2(8)(a), (b) and (c):
- Although sub-sections 2(8)(a) and (b) refer to the existing improvements, this does not negate the requirement that, in calculating site value, it must be assumed that the improvements ‘*had not been made*’ (having regard to the definition of ‘site value’ in s 2(1)). It must therefore be assumed that the land is vacant.
 - As we have indicated, s 2(8)(a)(i) requires an assumption to be made that the relevant part of the land may be used only for the purpose for which it was used at the date of valuation. This is inconsistent with and overrides s 5A(3)(a), which would otherwise require the land to be valued having regard to its highest and best use.

²³ As, for example, in the Cundall Valuation #2



- Read together, the three sub-paragraphs in s 2(8)(a)(i), (ii) and (iii) essentially provide, in relation to site value, that the unimproved land can ultimately only be used for its existing purpose and with the existing improvements, and no other improvements. The consequence of this is that the valuer must still assume that the land is vacant, but with its potential development and use confined by the existing building and the purpose for which it is being used.
- Section 2(8)(a)(ii) requires an assumption that all improvements on that land ... ‘may be continued and maintained *in order that* the use of the land ... may be continued’. The key words are in the linking phrase. The assumption is expressly ‘in order that’ the actual existing use in sub-paragraph (i) may be continued. It is simply seeking to assume the same heritage constraints on the potential use of the land – i.e. that the unimproved land can ultimately only be used for its existing purpose and with the existing improvements.
- It follows that, in our opinion, sub-paragraph (ii) neither mandates nor precludes a valuation method which uses a derived cost of development as one of its inputs - *provided that* the underlying assumption in the sub-paragraph is met. The cost of development is simply a functional element of some valuation methods (in order to derive the added value of improvements and/or land value), but not others, and its relevance is therefore dependent on the appropriateness or application of a particular model. However, in a model where the cost of development is relevant, the assumed development is constrained by all three parts of s 2(8)(a), and the approach must necessarily assume the same development and use as actually now exists. [Given that the interpretation and application of sub-paragraph (ii) is the key issue in dispute between the parties in this proceeding, we will deal with this issue further, in more detail, in the next section.]
- Section 2(8)(b) effectively provides that, in valuing the land, the part of the land in sub-section (b) cannot be valued in isolation from the other parts of the land in sub-sections (a) or (c). It must be assumed that the heritage-registered building cannot be removed or demolished, and that the other heritage registered land cannot be subdivided or developed unless a heritage permit has been granted. The assumption for the land in (b) therefore necessarily assumes that the assumptions for the land in (a) and (c) will be applied in the overall assessment of site value²⁴.
- Section 2(8)(c) provides that, in assessing the site value, it must be assumed that if a permit to subdivide or develop the land has been granted by the Heritage Council, the part of the land in (c) can only be subdivided or developed in accordance with ‘*that*’ permit. Here, a

²⁴ We do not consider that there was any material disagreement between the parties about this, albeit that it has some implications for the Cundall Valuation #2.



heritage permit has been granted²⁵, so the reference to ‘that’ permit in s 2(8)(c) is easy to discern. The valuer must make an artificial assumption that the vacant land can ultimately only be developed and used within the constraints of the existing improvements, in accordance with the heritage permit²⁶.

- 82 The comments we have just made about s 2(8) are based on the evidence and submissions before us, and by reference to some of the case law we will discuss in the next section.

CONSIDERATION OF RELEVANT CASE LAW

- 83 Both parties made extensive submissions about the permissibility and/or appropriateness of the valuation methods before us.
- 84 In doing so, the parties took us to a number of judicial decisions. We have considered all of the authorities provided to us, albeit that not all of them are separately analysed in this decision. However, we consider it appropriate to make some initial comments about some of them, which will assist in the discussion that follows.

The decision in *Australian Postal Commission*

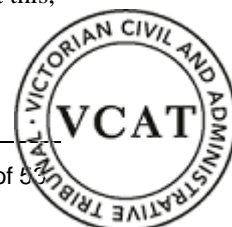
- 85 ISPT referred us to the decision of the Victorian Court of Appeal in *Australian Postal Commission v Melbourne City Council*²⁷.
- 86 The decision concerns an earlier valuation of the very same land. On 9 September 2001, the Melbourne GPO building was badly damaged by fire. A supplementary valuation was undertaken in December 2001. The Council valuer had considered that s 2(8) of the VL Act²⁸ did not exclude the potential for change in use or improvements over time, and that he was therefore able to consider the potential of the Melbourne GPO building for retail and commercial use. Indeed, that future potential was already largely known, as a 99-year lease had been signed with a developer before the fire. The owner’s valuer (the same Mr Brown, as here) considered he was bound by s 2(8) to value the land as if there could not be any change in use or improvement over time. Its actual use was still as a post office. As the cost of restoring the GPO to its pre-fire condition would be more than its capital improved value after restoration, Mr Brown was of the view that its capital improved value and therefore site value (as calculated in accordance with s 2(8)) were both nil as at the relevant valuation date.
- 87 The Court of Appeal held that s 2(8)(a)(ii) was inconsistent with, and overrode, s 5A(3)(a) of the VL Act. It prevented a valuer from valuing the land having regard to its highest and best use (i.e. its then potential use), rather than the existing use. The Court thus endorsed the approach adopted

²⁵ VHC Permit P6286, Tribunal Book 1295

²⁶ Again, we do not consider that there was any material disagreement between the parties about this, although it also has some implications for the Cundall Valuation #2.

²⁷ [2005] VSCA 295

²⁸ Section s 2(8) of the VL Act was then in the same form as now.



by Mr Brown and reduced the site value to nil. In the leading judgement, Charles JA and Nettle JA considered this ‘remarkable’ and ‘remarkably beneficial to the ratepayer’, but neither irrational or capricious having regard to the apparent purpose of the legislation.

- 88 The particular issue that was before the Court of Appeal in *Australian Postal Commission* is not in dispute here. Whilst we are clearly bound by the Court’s decision on that issue of law (i.e. that s 2(8)(a)(ii) overrides s 5A(3)(a)), we are not bound by the particular valuation method that the court endorsed in that case. No party suggested otherwise. The unusual circumstances of the valuation in 2001 (i.e. the cost of restoration of a fire damaged building, calculated as part of a supplementary valuation) means that the case is distinguishable on its facts. In any event, a merits valuation review before a court or tribunal does not attract the principle of *res judicata*, so the valuation method or outcome in preceding years is not binding in a subsequent year²⁹.
- 89 It is nonetheless relevant that, in relation to s 2(8) of the VL Act and the very same land, the Court of Appeal endorsed a valuation approach that essentially involved the use of a hypothetical development method, and it endorsed a ‘nil’ site value assessment. In the face of this, it is difficult for the Valuer General to contend here that a hypothetical development approach is wholly impermissible or inappropriate for the valuation of the Melbourne GPO land under s 2(8), or that a nil (or \$1) site value is absurd.

The NSW ‘Moneybox’ cases

- 90 The Valuer General referred us to a line of authority relating to the valuation over three separate rating periods of the Commonwealth Bank building in Martin Place, Sydney. The building is nick-named the ‘Moneybox’ because it was used as the model for money boxes issued by the bank over many years. The building was heritage listed under a planning instrument in NSW, and subject to valuation by reference to s 14G of the *Valuation of Land Act 1916 (NSW)*.
- 91 The relevant decisions are *Commonwealth Custodial Services Limited v Valuer General NSW*³⁰ (often cited as *Moneybox 1*), the appeal from that decision in *Commonwealth Custodial Services Limited v Valuer General NSW*³¹ (*Moneybox 1A*), *Commonwealth Custodial Services Limited v Valuer General NSW*³² (*Moneybox 2*), the appeal from that decision in *Valuer General NSW v Commonwealth Custodial Services Limited*

²⁹ See, for example, *Broken Hill Pty Co. Ltd v Municipal Council of Broken Hill* (1925) 37 CLR 284, 289 (Privy Council), cited with approval in *Moneybox 2* at [7] and *Moneybox 3* at [74], which are two of the NSW ‘Moneybox’ cases to which we will refer separately.

³⁰ [2006] NSWLEC 775, NSW Land and Environment Court, Talbot J.

³¹ [2007] NSWCA 365, NSW Court of Appeal

³² [2008] NSWLEC 310, NSW Land and Environment Court, Biscoe J.



(*Moneybox 2A*)³³, and *CFS Managed Property Limited v Valuer General NSW*³⁴ (*Moneybox 3*).

- 92 At the time of *Moneybox 1* and *Moneybox 1A*, s 14G of the NSW Act was in similar terms to s 2(8)(a) of the VL Act in Victoria, and s 6A(1) of the NSW Act (relating to the definition of ‘land value’) was in similar terms to the definition of ‘site value’ in s 2(1) of the VL Act³⁵.
- 93 The initial *Moneybox* cases therefore arguably provide some support for the use of a rent differential model for the valuation of a heritage-affected property. It was largely on this basis that the Valuer General advocated the use of a rent differential model in the current proceeding.
- 94 Despite the extent of the parties’ submissions devoted to the *Moneybox* cases, we do not believe we need to delve too far into them for the purpose of this decision, for a number of reasons.
- 95 First, the Cundall Valuation #1 relied upon by the Valuer General in this proceeding uses a variant of a rent differential model which is materially different from the rent differential model adopted in the initial *Moneybox* cases. Mr Cundall expressly conceded this during cross examination³⁶. The consequence of this is that the type of rent differential model adopted in the *Moneybox* cases is not a valuation methodology that is actually before us.
- 96 Secondly, the *Moneybox* cases are not binding upon us and can, in any event, be distinguished. Whilst there were for a time some similarities between ss 14G and 6A(1) in the NSW Act, and s 2(8)(a) and the definition of ‘site value’ in s 2(1) of the VL Act in Victoria, there are other material differences in the legislation, including the following:
- Victoria does not have the equivalent of the NSW s 6A(2), and NSW does not have the equivalent of s 2(2) in the VL Act.
 - The words ‘*Despite anything in this Act ...*’ in s 2(8) of the VL Act do not appear in s 14G of the NSW Act.
 - Whilst s 14G of the NSW Act was for a time similar to s 2(8)(a) of the VL Act, the NSW Act does not have (and appears never to have had) an equivalent provision to s 2(8)(b) and (c).
 - Various amendments to the NSW s 14G, in part to address some of the *Moneybox* decisions, means that the provision is now quite different to the provisions operating in Victoria.
- 97 Thirdly, and relatedly, the *Moneybox* cases deal with a building which was heritage listed under a planning instrument, to which s 14G of the NSW Act

³³ [2009] NSWCA 143, NSW Court of Appeal

³⁴ [2016] NSWLEC 2, NSW Land and Environment Court, Pain J.

³⁵ At VCAT’s request, the Valuer General provided a folder which set out the versions of ss 6A and 14G of the NSW Act at the time of each of the *Moneybox* decisions.

³⁶ See also, for transcript references and a more detailed discussion of this issue, ISPT’s written submissions at [76]-[112]



applies. Buildings on the NSW Heritage Register are valued under a separate provision in s 123 of the *Heritage Act 1977 (NSW)*. In *Krisgay Pty Ltd v Valuer General NSW*³⁷, it was considered little turned on this because the heritage valuation regimes under the two NSW Acts were to the same effect, and the legislature would not have intended a different approach. In Victoria, the situation is different. Section 2(8) of the VL Act deals only with land that includes a building on the Victorian Heritage Register. The heritage valuation regime for land containing a building listed under a planning scheme (such as under a Heritage Overlay) is quite different³⁸. In Victoria, the legislature has expressly provided for different outcomes.

- 98 Fourthly, as will be seen, the *Moneybox* cases provide little assistance in considering the hypothetical development approach as an appropriate valuation method, as opposed to considering a variant of the rent differential method.
- 99 Fifthly, by the time of *Moneybox 3* in 2016, the court indicated that the litigation history in *Moneybox 1/1A* and *Moneybox 2/2A* was ‘not conclusive of the appropriate valuation methodology’. Apart from not being bound by the earlier methods, the court indicated that:
- Provided the necessary assumptions required by the legislation are made within a particular valuation method, the court can have before it several methods which all may meet the statutory requirements³⁹.
 - The rent differential approach used in the earlier *Moneybox* cases had been criticised and its reliability was clearly in issue, albeit not finally determined⁴⁰. One of the key criticisms was that the hypothetical sales transaction must be consummated on the common understanding that the potential of the land is limited to a scenario where the only building that may be erected on the vacant land is an exact physical replica of the existing building. It was argued that the rent differential approach used in the earlier *Moneybox* cases failed to make that assumption. This criticism is clearly relevant to the dispute in this proceeding, and clearly undermines the Cundall Valuation #1.
- 100 Despite all of the above, there is some useful discussion in the *Moneybox* cases about a number of comparable issues and principles that, considered with care because of the distinguishing factors we have mentioned, is nonetheless relevant to the issues debated in this proceeding. We will refer to some of the *Moneybox* cases in this limited context.

³⁷ [2007] NSWLEC 600 at [33], NSW Land and Environment Court, Biscoe J.

³⁸ In Victoria, the valuation of land to which a Heritage Overlay applies is dealt with indirectly under s 2(9) of the VL Act. If a planning permit is required to pull down or remove a building, and has been refused, the site value ‘... must be calculated on the basis that the building cannot be pulled down or removed’. Section 2(9) does not have the same assumptions as in ss 2(8)(a),(b) and (c).

³⁹ *Moneybox 3*, op cit, at [73], including with reference to *Valuer General NSW v In Adam Pty Ltd* [2012] NSWCA 20 at [23].

⁴⁰ *Moneybox 3*, op cit, at [75]-[80]



The decisions in *Tooheys* and *Fenton Nominees*

- 101 The Valuer General referred us to the Privy Council decision in *Toohey's Limited v Valuer General NSW*⁴¹, and the High Court decision in *Valuer General SA v Fenton Nominees*⁴².
- 102 *Tooheys* stands for the principle that, in assessing the unimproved or site value of land, it is not permissible to arrive at the figure by identifying the value of the site in its improved state and then subtracting the value of the improvements. That is because any improvements are to be taken not only as non-existent, but as if they never existed.
- 103 This principle was enunciated in relation to the definition of 'unimproved value' in s 6A of the *Valuation of Land Act 1916 (NSW)* which, considered in isolation, is similar in effect to the definition of 'site value' in s 2(1) of the VL Act in Victoria.
- 104 The principle in *Tooheys* has been cited with approval in many cases, including by the High Court in *Fenton Nominees*. The High Court there considered the principle in *Tooheys* to be well-settled.
- 105 At least two of Mr Brown's valuation methods in this proceeding purport to use a methodology that may be impermissible under the principle in *Tooheys*. The Brown Valuation #2 calculates the capital improved value less the depreciated value of improvements. The Brown Valuation #3 calculates the capital improved value less the replacement cost of improvements.
- 106 It will be apparent to anyone familiar with valuation law that the principle in *Tooheys* is not without its critics. Neither *Tooheys* nor *Fenton Nominees* concerned heritage-registered buildings. The principle in *Tooheys* is also more difficult to rationalise in relation to a provision such as s 2(8) of the VL Act, which requires a valuer assessing site value to nonetheless make artificial assumptions about existing improvements being 'continued and maintained' in order to continue the existing use.
- 107 Indeed, in *Moneybox IA*⁴³, Spiegelman CJ considered this matter. His Honour stated in relation to a similar but not identical heritage provision in s 14G of the *Valuation of Land Act 1916 (NSW)*:

[10] In my opinion, the reasoning in *Tooheys* is an inadequate foundation for continuing to exclude a rational approach to valuation which is accepted as permissible by expert valuers. This is of particular significance, in a case like the present, by reason of the difficulties involved in valuing land in an urban environment, where unimproved land sales are rare, and even more so in the context of heritage listed property, where removing the improvements is impermissible.

⁴¹ [1925] AC 439

⁴² (1982) 150 CLR 160

⁴³ *Moneybox IA*, op cit, at [10] – [18]



- 108 However, after noting the approval of *Tooheys* by the High Court in *Fenton Nominees*, Spigelman CJ concluded ‘with some reluctance’ that the court should follow *Tooheys* and leave it to the High Court to reconsider the issue if it wished to do so.
- 109 Neither party before us was aware of a case where this dilemma had been judicially considered or resolved in Victoria. However, we note that:
- The equivalent provision in NSW is not preceded by the words found in s 2(8) of the VL Act in Victoria: ‘*Despite anything in this Act ...*’. If there is an inconsistency between s 2(8) and an aspect of the definition of ‘site value’ in s 2(1), then it is arguable that the principle in *Tooheys* may have less relevance to the resolution of that inconsistency in Victoria.
 - The VL Act has a s 2(2), inserted into the Act in 1989, that starts with the words: ‘*In estimating the value of improvements on any land for the purpose of ascertaining the site value of the land, the value of the improvements is the sum by which the improvements upon the land are estimated to increase its value ...*’. The VL Act therefore appears to specifically contemplate the potential to calculate site value by reference to the improvements, albeit that we accept that the ‘value’ of improvements is not necessarily the same as their ‘cost’. We are not aware of an equivalent provision in the NSW Act. The existence of s 2(2) may again mean that the principle in *Tooheys* has less relevance in Victoria.
- 110 We do not need to resolve these issues in this proceeding. They are perhaps a matter for a court to adjudicate upon at some stage.
- 111 In reality, we think the references to *Tooheys* in this proceeding are somewhat of a distraction. This is because:
- The hypothetical development approach in the Brown Valuation #1 does not offend the principle in *Tooheys*.
 - The principle in *Tooheys* at most affects the permissibility of the Brown Valuation #2 and the Brown Valuation #3. Mr Brown only uses these as ‘check’ valuations. They are not determinative to his primary method of valuation, nor are they (for similar reason) determinative to us.
- 112 In *Moneybox 1A*, Tobias J gave what is considered to be the leading judgement. He had less difficulty than Spigelman CJ in approving and following the principle in *Tooheys* and *Fenton Nominees*. This led to a decision to disallow as impermissible a valuation that clearly offended the principle, where a valuer had effectively worked backwards from the capital improved value to derive a site value.
- 113 After considering other authority, Tobias J postulated the scenario whereby a valuer first assumed the land to be vacant, and then considered what



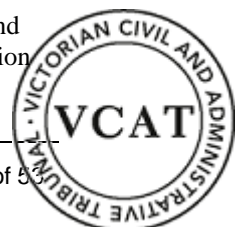
improvements would be placed on the land in order to put it to its highest and best use. The valuer would ‘then ascertain the return which would be derived from the land with its *assumed* improvements and would then derive the unimproved value by deducting from the value of the land the value which the assumed improvements added to the land, which would be their cost’⁴⁴.

- 114 Under this scenario, the valuer is not working backwards from the existing improved value to derive a site value but is starting with an assumption of vacant land and assuming the improvements. Tobias J indicated that, had the valuer adopted such an approach in the case before him, ‘it would not run foul of the decision in *Tooheys*’.
- 115 Despite his reluctance to fully endorse *Tooheys*, Spiegelman CJ also found this reasoning to be ‘entirely convincing’ as to the validity of the valuation mechanism in issue⁴⁵.
- 116 The valuation method disallowed in *Moneybox 1A* was not a hypothetical development method, nor comparable with the Brown Valuation #1 methodology in the present case⁴⁶.
- 117 As we understand it, the orthodox hypothetical development approach used by Mr Brown starts with an assumption that the land is vacant. On the assumption that the land is vacant, Mr Brown’s approach then hypothesises a notional development that generates a gross realisation based on a capitalised net market income and adjusted for capital expenditure, and then an appropriate allowance for profit and risk and the deduction of the costs of development. It is simply the case that the notional or hypothetical development used in such a model here is constrained by all three parts of s 2(8)(a), and the approach must therefore assume that the hypothetical development is the same development and use as actually exists. This approach is not therefore deducting existing improvements from the CIV to derive site value, nor assuming the removal and reinstatement of the existing GPO building. Mr Brown is simply hypothesising a notional development that must, because of s 2(8)(a), meet the same criteria as the existing building in terms of its development and use.
- 118 Logically, and following the reasoning of Tobias J in *Moneybox 1A*, Mr Brown’s approach does not run foul of the decision in *Tooheys*. Indeed, in our opinion, it implicitly gives effect to it.
- 119 Accordingly, to the extent the Valuer General relies upon *Moneybox 1A* and its support for the principle in *Tooheys* in a heritage valuation case on somewhat equivalent terms, these authorities do not provide any basis for a finding that the Brown Valuation #1 is legally impermissible.

⁴⁴ *Moneybox 1A*, op cit, at [59] – [60]

⁴⁵ *Moneybox 1A*, op cit, at [13]

⁴⁶ As we understand it, the method disallowed in *Moneybox 1A* was an approach of assessing land value by deducting from the CIV an amount for improvements calculated on a rent capitalisation basis (see *Moneybox 1* at [28]).



- 120 Insofar as the Brown Valuation #2 and the Brown Valuation #3 are concerned, they are only put before us as check valuations. As a general principle, we think there is merit in having a primary valuation capable of being ‘checked’ by alternative approaches.
- 121 Although not finally decided, there is some support for proposition that the principle in *Tooheys* need not be strictly followed other than for a primary valuation. We agree with ISPT that the case law, even in NSW, cannot be read as giving rise to a blanket prohibition on site value being determined on the basis of CIV less value of improvements⁴⁷. Such a method is often used to ‘adjust’ comparable sales. In our opinion, it may perhaps also be used (and be useful) as a *check* method in other appropriate cases – particularly in Victoria given the existence of s 2(2) in the VL Act. It is also useful given the difficulties in the practical application of s 2(8) in a proceeding such as this. We say this without conceding that the Brown Valuation #2 and the Brown Valuation #3 are necessarily impermissible in Victoria as primary valuation methods. For the reasons given, that does not need to be decided here.

The decision in *In Adam*

- 122 The final case we seek to comment upon expressly is *Valuer General NSW v In Adam Pty Ltd*⁴⁸.
- 123 As with the *Moneybox* cases, some caution needs to be applied in reference to a NSW decision due to differences in the legislation. By the time of *In Adam*, s 14G of the NSW Act was still in similar form to s 2(8)(a) of the VL Act, save that the improvements to be ‘*continued and maintained*’ (i.e. under the equivalent sub-paragraph to s 2(8)(b)(ii) of the VL Act) were assumed to be new, rather than in their actual condition⁴⁹.
- 124 Putting to one side this issue, we agree with ISPT that the relevant principle to be drawn from this decision is the recognition, even under the NSW legislation, that the additional costs of having to construct the improvements on the land can be taken into account. The Court of Appeal noted the artificiality of the assumptions that the legislation required, but also noted that the imaginary heritage restricted building which must be assumed as real ‘*has as one of its inevitable corollaries an imaginary cost of construction*’. A hypothetical willing and informed purchaser would take into account the restrictions that reduce the value of the land. The hypothetical purchaser would thus take into account the cost of construction, in negotiating for the purchase of the land, on the basis of the

⁴⁷ See *Moneybox 3*, op cit, at [84]-[94], and *Valuer General NSW v Oriental Bar Pty Ltd* [2016] NSWCA 48, particularly at [23] per Basten JA

⁴⁸ [2012] NSWCA 20, NSW Court of Appeal, particularly at [26].

⁴⁹ This change to the NSW provision had occurred as a result of the appeal decision in *Moneybox 1A*. In relation to a heritage restricted property, the change allowed a valuer to assume an allowance for the cost of erecting a modern building of the same size with the same net lettable area, rather than an identical heritage building, which had the effect of increasing the calculated land value because the cost of erecting an identical heritage building would have been much higher.



legislative assumption that it could not use the land without the assumed improvement.

- 125 We were informed that the decision in *In Adam* resulted in a further amendment to s 14G in NSW, which required the purchaser to assume that ‘the cost of improvements on that land has no effect on its land value’. The rationale for the amendment perhaps reinforces the principle that existed in the absence of such amendment – i.e. that the hypothetical cost of improvements *would* otherwise affect site value. The amendment in NSW also perhaps reinforces the position that NSW, unlike Victoria, has taken active legislative steps to negate the effective use of a hypothetical development approach to the valuation of a heritage restricted property in that state.

FURTHER CONSIDERATION OF ISSUES

To what extent can the ‘cost of construction’ be considered?

- 126 Having considered some of the relevant case law, we return to the key issues in dispute that have not been wholly resolved in the foregoing discussion.
- 127 There was considerable debate about the meaning of s 2(8)(a)(ii) and whether the sub-paragraph rendered particular valuation methods impermissible or inappropriate. Sub-paragraph (ii) requires an assumption that all *improvements on that land ... may be continued and maintained in order that the use of the land ... may be continued*.
- 128 We have already addressed one aspect of this sub-paragraph, in terms of the uneasy artificial construct it raises when applied to the assessment of site value. Under the definition of ‘site value’ in s 2(1) of the VL Act, a valuer must assume that any improvements had not been made. The introduction of s 2(8)(a)(ii) potentially requires the valuer to accept that the improvements will exist, but to value the land as if they did not.

Valuer General's approach to s 2(8)(a)(ii)

- 129 The Valuer General's preferred interpretation is that the words in s 2(8)(a)(ii) that assume that improvements may be ‘*continued and maintained*’ negate a valuation method that factors in the cost of reconstructing of the GPO building in its existing state. It says that, for the purpose of assessing site value, the necessary ‘stripping’ of the improvements to meet the s 2(1) requirement (i.e. that the improvements do not exist) only occurs in a hypothetical sense. The Valuer General submits that there is no ‘real world’ removal of the existing improvements that necessitates a ‘real world’ reinstatement of those improvements.
- 130 We agree with the Valuer General that there is no ‘real world’ removal and reinstatement of improvements, and that sub-paragraph (ii) relies on an artificial hypothesis. But we do not agree that the cases the Valuer General



referred us to⁵⁰ support the view that the only consequence of this is to negate all valuation methods that rely, in part, on the cost of constructing the GPO building. The cost of construction is simply part of the artificial hypothesis.

- 131 As we have indicated, properly considered, Mr Brown's hypothetical development approach starts with the assumption that the land is vacant. It is not an approach that 'strips' the land of the existing improvements in order to meet the s 2(1) requirement that the land is unimproved. There is no 'real world' removal and reinstatement of the extant GPO building. It is simply the case that, by reference to the assumptions in s 2(8)(a), the 'hypothetical' development used in the model must necessarily assume the same development as already actually exists.
- 132 We agree with ISPT that the words '*in order that ...*' in s 2(8)(a)(ii) are important to the interpretation of the sub-paragraph. The assumption that the existing improvements may be 'continued and maintained' is not an end in itself. It is expressly '*in order that*' the actual existing use may be continued. As we have said, the artificial hypothesis is simply seeking to assume the same heritage constraints on the *use* of the land – i.e. that the unimproved land can ultimately only be used for its existing purpose and with the existing improvements, and no other improvements.
- 133 Equally, however, we are not convinced that s 2(8)(a)(ii) *requires* a valuation exercise that factors in the cost of constructing and maintaining a copy of the GPO building, as ISPT implicitly contends. In our opinion, the cost of construction is simply a functional element of the hypothetical development approach and the two check methods, rather than a necessary requirement under subparagraph (ii).
- 134 Further support for this proposition arises from the decision in *In Adam* to which we have referred above. The cost of construction was clearly relevant in that case. The decision in *In Adam* is also referenced in *Moneybox 3*⁵¹ in the context of there being no single valuation method required to meet the legislative assumptions and that, provided the necessary assumptions required by the legislation made within a particular valuation method, the court could have before it several permissible methods for consideration.
- 135 Similarly, in Victoria, there may be other potential valuation approaches that could conceivably meet the assumption in subparagraph (ii) without relying upon the cost of construction. We say 'conceivably' because it is

⁵⁰ e.g. *Longreach Capital Pty Ltd v Valuer General NSW* [2007] NSWLEC 721, and *Olefines Pty Ltd v Valuer General NSW* [2018] NSWLEC 18. As far as we can ascertain, none of these cases addressed the appropriateness of a hypothetical development model at all, nor the particular facts and circumstances before us in this proceeding. We note that *Olefines* has since been the subject of an unsuccessful appeal on other grounds - [2018] NSWCA 265.

⁵¹ *Moneybox 3*, op cit, at [73]



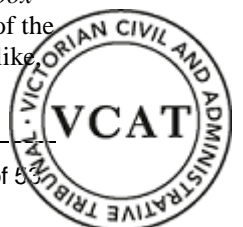
not our task to undertake that analysis, and we have not done so. We are only concerned with the particular valuations in evidence before us.

- 136 However, although we do not need to finally decide the issue, the rent differential method used in NSW in *Moneybox 1* was considered to meet the relevant assumptions. The actual rental returns included in the model arguably took into account the heritage nature of the building, including its condition, shape and efficiency, and thus reflected an assumed continuation of the existing improvements for the existing use, which is then compared to derived rental returns for a hypothetical development that is not heritage constrained⁵².
- 137 It follows that we consider that the parties have both taken an unduly narrow view of subparagraph (ii) in their respective submissions that the provision allows only for their preferred valuation approach, and no other. In our opinion, subparagraph (ii) prescribes an assumption that must be met but does not dictate a sole method by which that assumption must be met. As we have indicated, we consider that subparagraph (ii) does no more than require an artificial assumption that the unimproved land can ultimately only be used for its existing purpose within the constraints of its existing improvements, and with no other improvements. There may conceivably be more than one way of dealing with that assumption.

Valuer General's alternative approach to s 2(8)(a)(ii)

- 138 As an alternate construction to s 2(8)(a)(ii), the Valuer General places emphasis on the use of the word 'may' in the sub-paragraph. To the extent the Valuer General may be arguing that there is a general or permissive discretion to consider whether the existing improvements need to be continued or maintained as a relevant assumption, we disagree. This would be illogical to the underlying purpose and operation of s 2(8)(a). However, we consider that the use of the word 'may' in the context of the rest of the sub-paragraph bolsters the view we have expressed above; namely, that subparagraph (ii) is simply requiring an assumption that, in assessing the site value, the unimproved land can ultimately only be used for its existing purpose within the constraints of its existing improvements. Sub-paragraph (ii) is not directing that this can only be achieved by considering the cost of development, or a rent differential, or any other particular approach.
- 139 To the extent the Cundall Valuation #2 is largely based on this alternative construction of s 2(8)(a)(ii), we consider that valuation to be flawed.

⁵² We say 'we do not need to finally decide the issue' because the rent differential method used in *Moneybox 1* is different to the rent differential method used by Mr Cundall, and we are not required in this case to deal with the criticisms of the rent differential method noted in *Moneybox 3*, particularly at [76]. Also, we do not need to resolve here potential impediments to the use of the rent differential method used in *Moneybox 1* in Victoria where the legislation differs – e.g. unlike NSW, Victoria has s 2(8)(b) and (c) in the VL Act.



Approach to s 2(8)(a)(iii)

- 140 Section 2(8)(a)(iii) is more straightforward, but it expressly links to sub-paragraph (ii). Read together, they require an assumption that the unimproved land can ultimately only be used for its existing purpose and with the existing improvements, *and no other improvements*.
- 141 In similar fashion to our comments above, we do not agree with ISPT that this provision necessarily mandates only a valuation method that has regard to the cost of development. We do however agree that, if an appropriate valuation method is adopted which utilise a derived cost of development as one of its inputs, the effect of sub-paragraph (iii) is that the hypothetical development would need to be based on the actual existing improvements, rather than on a modern equivalent or different building. This is consistent with the principles in the case law that we have considered earlier.
- 142 Equally, in similar fashion to our comments above, we do not agree with the Valuer General that subparagraph (iii) can only be read on the basis that the hypothetical purchaser is not compelled to make any improvements at all to the land.

Approach to s 2(8)(c)

- 143 The relevance of the cost of construction also arises in relation to that part of the land covered by s 2(8)(c) – i.e. here, the L-1 land on the VHR Plan. If a permit to subdivide or develop the land has been granted by the Heritage Council, it must be assumed that the land can only be subdivided or developed in accordance with that permit.
- 144 In our opinion, there may again be more than one way of dealing with this assumption. Consistently with what we have said earlier, we do not believe that s 2(8)(c) expressly requires or negates a valuation method which uses a derived cost of development (or cost of construction) as one of its inputs. However, if such a method is used, we agree with ISPT that the hypothetical development would need to be based on the actual existing improvements for the L-1 land under the relevant heritage permit, rather than for a different building. If an alternative method is used, it would still need to meet the assumption by taking into account that the only development capable of being undertaken on the L-1 land (and the returns derived from that development) would be for the development authorised under the Heritage Council permit.
- 145 As will be seen, despite there potentially being more than one way of dealing with the assumptions under s 2(8)(c), we do not consider that the rent differential model in the Cundall Valuation #1 meets the relevant assumption.



Conclusions on using a valuation method that relies upon the ‘cost of development’

- 146 Here, we think the Brown Valuation #1 does meet the relevant assumptions in s 2(8). In particular, from the discussion above, we are of the opinion that Mr Brown’s use of a hypothetical development approach is not legally impermissible having regard to the assumptions in s 2(8).
- 147 Accordingly, to the extent such an approach relies upon an assumed ‘hypothetical development’ (as the name suggests), the requirements of s 2(8) require the valuer to assume that the hypothetical development comprises the actual existing improvements, and no other improvements. Here, the cost of the hypothetical development that is factored into the model will therefore necessarily reflect the cost of construction of a building equivalent to the existing Melbourne GPO.

Value of Improvements

- 148 We have made comments above about the cost of development. The Valuer General raised other issues about the way in which ‘improvements’ were allowed for by Mr Brown in his valuation approaches.

- 149 The term ‘improvements’ is defined in s 2 of the VL Act as follows:

improvements, for the purpose of ascertaining the site value of land, means all work actually done or material used on and for the benefit of the land, but only in so far as the effect of the work done or material used increases the value of the land and the benefit is unexhausted at the time of valuation ...

[some exceptions are then set out in the definition, which the parties agree are not relevant here].

- 150 As we have indicated, s 2(2) of the VL Act also provides:

- (2) In estimating the value of improvements on any land for the purpose of ascertaining the site value of the land, the value of the improvements is the sum by which the improvements upon the land are estimated to increase its value if offered for sale on such reasonable terms and conditions as a genuine seller might in ordinary circumstances be expected to require.

- 151 We agree with the Valuer General that the ‘*value* of improvements’ is not the same as the *cost* of those improvements. An approach that simply deducts the replacement cost of a building from the CIV will not necessarily be a good indicator of site value.

- 152 Mr Brown acknowledges this. We agree with Mr Brown that a valuer’s opinion about the added value of improvements still needs a defensible reference point. Commonly, the added value of improvements will be supported by comparable sales, but this is not possible here. Although there are sales of heritage-registered sites that are improved, in order to analyse the added value of the improvement, sales of vacant land (or similar) of heritage-registered sites are required to complete that analysis. There are



none, given the nature of s 2(8), as there can logically be no vacant or unimproved land containing a heritage-registered building. This becomes a circular reference in that if the heritage-registered land sales were available in the first place, it would negate the need for the analysis.

153 Accordingly, in the absence of comparable sales, Mr Brown has referenced the added value of improvements to the construction cost and/or the construction cost less depreciation. In the circumstances, we consider that to be appropriate, provided the reference is appropriately analysed (and, if necessary, adjusted on a defensible basis) within the valuation exercise.

154 As a corollary, the Valuer General contends that the value attributed to the improvements (through a reinstatement or construction cost) gives rise to a negative land value, and that Mr Brown's methods indicate that the Melbourne GPO building is not an 'improvement' because it does not benefit the land or increase the value of the land.

155 The Valuer General uses the example of the Brown Valuation #3 - a check method based on CIV less replacement cost. Mr Brown's replacement cost is in the order of \$286 million, and he deducts this from his derived CIV in the order of \$81 million, to give a negative land value of minus \$205 million. The Valuer General contends that an 'improvement', as defined, can only be the amount by which works or materials *increase* the value of the land, and the negative value here therefore exposes a flaw in all of Mr Brown's valuation methods because the so-called improvement has a negative influence (rather than benefitting the land) and actually reduces rather than enhances the land value.

156 However, we consider the Valuer General has misconceived the situation, and has put the argument the wrong way around.

157 Using the same example, if the CIV is \$81 million, and the site value is minus \$205 million, the improvements have increased the value by the difference between the two. Moreover, Mr Brown recognises that, for practical purposes, the site value cannot be negative, and therefore derives a nominal site value of \$1. On this analysis:

- The capital improved value of the land (including the existing Melbourne GPO) is \$81 million.
- The site value (i.e. assumed vacant/unimproved land) is \$1.
- The 'improvements' comprised in the Melbourne GPO building have therefore *increased* the value of the land by \$81 million from its underlying site value. The improvements have not reduced the land value, as the Valuer General contends.
- The cost of the improvements differs from the assessed 'value of improvements'. Although the replacement cost of the building is \$286 million, the added value of the building, for statutory purposes, is only \$81 million.



158 Considered in this way, we consider that Mr Brown’s valuation methods properly respond to the requirements of the VL Act in the manner in which the ‘improvements’ have been assessed.

Is the hypothetical development approach inherently inappropriate for heritage-registered land?

159 Even if legally permissible, the Valuer General contended that Mr Brown’s hypothetical development approach was entirely inappropriate for the valuation of land that includes a heritage-registered building such as the Melbourne GPO, particularly on the basis that it produced an ‘absurd’ outcome resulting in a nominal site value of \$1.

160 The Valuer General contended that the hypothetical development approach had been rejected in *Moneybox 1*⁵³. Properly considered, we think that overstates the position. The court in *Moneybox 1* noted the opinion of the Valuer General’s valuer that the negative or nil land value deduced was evidence that the methodology was flawed in circumstances where a high rental income had been generated. However, the court also noted that the hypothetical development approach had not been considered by either party as part of their primary valuations or until the valuation experts conferred, and that the approach had not been seriously considered nor represented anything other than a ‘back of the envelope’ calculation. The court distinguished the *Australian Postal Commission* decision by the Victorian Court of Appeal (to which we have earlier referred).

161 The Valuer General also submitted that the hypothetical development approach had been rejected in *Moneybox 3*⁵⁴. There, the court agreed with a criticism of the hypothetical development approach because of the large number of subjective inputs required, which could deliver a wide variance in resultant land values. In that case, it considered the valuation outcome achieved for the land through the use of the hypothetical development approach to be an absurd result.

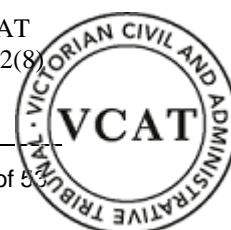
162 It is true that a hypothetical development approach relies on subjective inputs, and it is sometimes considered undesirable as a primary valuation method – including in Victoria⁵⁵. It seems that one of the key reasons that the Valuer General has intervened in this proceeding is because of its view that a hypothetical development approach will commonly result in a nil or nominal site value (because the ‘hypothetical’ development will necessarily factor in the cost of constructing the existing improvements), and that this is so absurd that it tends against the use of this method.

163 We share some of the Valuer General’s reservations about the use of a hypothetical development approach for land covered by s 2(8) of the VL

⁵³ *Moneybox 1*, op cit, at [27]-[29]

⁵⁴ *Moneybox 3*, op cit, at [46]-[48]

⁵⁵ See, for example, *PTDA & Civic Nexus Pty Ltd v Commissioner of State Revenue* [2016] VCAT 1457, per Garde P, although that matter did not concern a heritage valuation constrained by s 2(8) of the VL Act.



Act. It is why we have indicated elsewhere in these reasons that we do not find such an approach ‘ideal’. However, against this:

- As we have found, the hypothetical development approach is legally permissible, and meets the assumptions in s 2(8) of the VL Act.
- We agree with ISPT that a hypothetical development approach is an accepted and orthodox valuation methodology for site value where there are no comparable sales⁵⁶.
- We are mindful that, in *Australian Postal Commission*, the Victorian Court of Appeal found that, although ‘remarkable’ and ‘remarkably favourable to the ratepayer’, a nil valuation arising from the use of a hypothetical development approach for a heritage valuation of the Melbourne GPO under s 2(8) was neither irrational or capricious or contrary to the purpose of the legislation. It cannot therefore be considered that, in Victoria, the use of the hypothetical development approach leads to an outcome that would be considered absurd.
- We agree with ISPT that the use of a hypothetical development approach for a valuation under s 2(8) of the VL Act will not *always* lead to a nil site value for all land covered by that provision.
- We are not bound by criticisms of the hypothetical development method in heritage valuations in NSW. For reasons we have outlined earlier, the position in NSW is different.
- Even though a hypothetical development method may rely on arguably *subjective* inputs, Mr Brown provided a reasoned basis for all of the inputs he used in his approach. The Valuer General did not specifically attack or undermine any of the inputs used by Mr Brown (e.g. depreciation rates) in the Brown Valuation #1.
- Moreover, the rent differential method used by Mr Cundall arguably relies on even greater subjective inputs, and many of these were attacked by Mr Brown in his evidence, or by ISPT in its cross examination of Mr Cundall. Also, even Mr Cundall relies on a hypothetical development approach for part of his Cundall Valuation #2.

164 In the absence of any other permissible and appropriate valuation methodology before us in this proceeding, we consider the use of the hypothetical development method in this proceeding to be acceptable, albeit not ideal.

⁵⁶ See, for example, Hyam ‘The law affecting valuation of land in Australia’ (5th ed, 2014), particularly at p 183 and the commentary and cases cited therein.



CONSIDERATION OF NON-VALUER EVIDENCE

Witness evidence

165 The primary evidence before us is contained in the witness statements, reports and affidavits of the following:

ISPT's witnesses:

- Stephen Grimes (quantity surveyor)
- Bryan Maloney (property manager)
- Amanda Ring (town planner)
- Leslie Brown (valuer)

Valuer General's witnesses:

- Rob Milner (town planner)
- Karl Cundall (valuer)

166 With the exception of Mr Maloney (who gave lay evidence), all of the witnesses are to be regarded as expert in their respective fields. Ms Ring, Mr Brown and Mr Cundall were called to give evidence and cross-examined at the hearing.

167 Mr Maloney managed the 2004 refurbishment of the Melbourne GPO and the rear extension and redevelopment. His uncontested evidence, which we accept, was that the cost of these works was approximately \$41 million.

168 Apart from the witness evidence, we were also provided with a multi-volume Tribunal book containing additional relevant material.

Relevant use

169 As we have indicated, s 2(8)(a)(i), requires an assumption that the land may only be used for the purpose for which it was used at the date of valuation. This overrides the operation of s 5A(3)(a) that would otherwise have required a consideration of the highest and best use.

170 Here, however, this factor is largely academic. The actual use of the land as at 1 January 2016 was for the purpose of retail and commercial use, and both valuers and planners were generally agreed that a continuation of this actual existing use would also be the highest and best use of the land.

171 We note for the record that ISPT submitted that, to properly apply s 2(8)(a)(i), the existing uses would need to be precisely determined and characterised having regard to separate 'zones' within the GPO building used for the purposes of retail, food and commercial uses, and on the basis that these zones could *only* be used for those specified purposes. Some support for this proposition is found in the decision in *Olefines Pty Ltd v*



*Valuer General New South Wales*⁵⁷. We are not necessarily convinced that the individual uses need to be so precisely identified or established on a ‘zone’ basis in this way, given that s 2(8)(a)(i) refers only more broadly to the *purpose* for which the *land* was used at the relevant date. However, it is unnecessary to finally decide that issue in this proceeding.

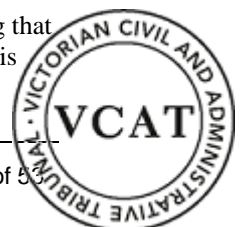
Quantity surveyor evidence

- 172 Mr Grimes’ largely uncontested evidence was that the estimated cost of constructing the existing improvements on the land as at 1 January 2016 was \$269,968,000 for the original building, and \$16,915,000 for the extension, a total of \$286,883,000.
- 173 Mr Grimes noted that it was not possible to prepare a quantitative assessment of the additional cost of sourcing and constructing the building with materials of the same age and condition as the existing building (e.g. 19th century bluestone from the same quarry, no longer available), and his estimated cost of construction is therefore conservative.
- 174 The Valuer General led no evidence about the cost of constructing or re-constructing the improvements and did not cross-examine Mr Grimes.
- 175 We accept Mr Grimes’ evidence, noting that it was relied upon by Mr Brown for his valuations, and forms a major underpinning of his site value calculations.

Planning evidence

- 176 The opinion of a town planner is often important to a valuation exercise. The significance of the planning evidence is that it should underpin the assumptions or inputs in the valuation evidence where the valuer relies on planning matters beyond the valuer’s own expertise – for example, in seeking to ascertain the highest and best use or development potential of land, having regard to existing or likely planning or heritage constraints.
- 177 Given the relevant use and development of the Melbourne GPO building is constrained by the assumptions in s 2(8) of the VL Act, Mr Brown has (in our opinion, correctly) based his valuation approaches on assumptions related to the existing building and existing use. He did not consider that there was a requirement to value the unencumbered or unrestricted site value, and he did not therefore need to rely materially on planning advice in that regard. Mr Brown nonetheless notes that he considered:
- A town planning report prepared by Andrew Biasci of Contour Consultants in 2009, indicating the significance of the Melbourne GPO, and concluding that there would be little (if any) significant change to the built form, and that its potential for accommodating any major change is severely constrained by a combination of planning

⁵⁷ [2018] NSWLEC 18, at [122] & [128] per Molesworth AJ. We were advised after the hearing that this decision was the subject of an unsuccessful appeal – it appears on grounds unrelated to this issue - [2018] NSWCA 265.



and heritage limitations under relevant controls. [Mr Brown also noted the key zoning and overlay controls had remained unchanged since Mr Biasci's report].

- A heritage opportunities and constraints report prepared by Peter Lovell of Lovell Chen in 2012, in particular outlining constraints created by the internal reconfiguration of the Melbourne GPO, the Conservation Management Plan, and the heritage permit.

- 178 Although we were not taken to this material directly, some of it is contained in the Tribunal Book and/or is summarised in other documents. We consider that this material provides a satisfactory underpinning for Mr Brown's valuation on planning and heritage matters outside Mr Brown's own expertise.
- 179 The parties both proffered town planning evidence, for different reasons, relating primarily to Mr Cundall's valuations. As a number of Mr Cundall's steps in the Cundall Valuation #1 and Cundall Valuation #2 rely materially on planning assumptions (unlike Mr Brown's valuations), the opinions of both expert planners are highly relevant.

Milner evidence

- 180 The Valuer General relied upon the expert report of Robert Milner of 10 Consulting Group. We note that Mr Milner's report is primarily referable only to the Cundall Valuation #1, as his report pre-dates the Cundall Valuation #2, and he was not called to give evidence at the hearing.
- 181 Mr Milner was asked to give his opinion on the most likely form of development at the relevant date that would maximise the yield of the land, assuming no heritage constraints, but assuming all other planning controls continued to apply. Mr Milner clearly sets out in his report the factors that influenced his opinion, none of which were challenged by ISPT. Mr Milner's opinion was ultimately that the overall yield of gross developable space, for the highest and best use, would be 23,618 m², but if greater ceiling heights were introduced to conform with contemporary standards, the overall yield would be 20,244 m².
- 182 Mr Milner's evidence was not challenged, and we accept it within the context in which it was given.
- 183 The significance of Mr Milner's planning evidence is that it should have underpinned the assumptions or inputs in the valuation evidence.
- 184 However, Mr Cundall indicated he had not accepted or followed this planning opinion from his own client's expert planner. Indeed, the Cundall Valuation #1 was prepared before Mr Milner's report and was not revised in the light of that report.
- 185 Mr Cundall instead relied on a 'theoretical rebuild' prepared by DELWP, with an assumed yield of 32,000 m² (i.e. well above Mr Milner's estimates). The DELWP material comprised a one-page computer simulation.



Moreover, Mr Cundall ignored the caveats in the provision of this material by DELWP. Two emails from DELWP to Mr Cundall⁵⁸ had stated:

The maximum GFA determined was 32,000sqm. ... It should be noted that this is not an architectural design for the site; the 32,000 sqm would definitely decrease based on design decisions – i.e. mezzanine levels, a curved building form etc, and therefore **is both maximum, and theoretical**.

[This bolding appears in the email]

and

... thanks for confirming that you are taking the piece of work I have provided as a valuation defence if the GPO site was completely empty, *rather than as a potential development scenario*. As discussed, the GPO is an incredibly significant building, and any changes, even minor, would have to go through Heritage Victoria for approval. *Nothing like the scenario I've provided would ever be allowed to happen on the site.*

[Our italics for emphasis]

- 186 No evidence was led by the Valuer General in support of the DELWP 'theoretical rebuild'. The Valuer General continued to rely upon Mr Milner's evidence, whilst still attempting to promote Mr Cundall's valuation. Mr Cundall however conceded in cross-examination that, if Mr Milner's evidence was accepted, the unencumbered site value used as the denominator in his rent differential method would be wrong, and the site value would be much lower.
- 187 As a major step in the Cundall Valuation #1 relies upon planning assumptions about the hypothetical highest and best use and development, we consider there is no satisfactory underpinning for his valuation from a planning perspective. His failure to accept and rely upon his own client's expert planning report in our opinion seriously undermines his valuation evidence and exposes a serious flaw in a critical input in his model.

Ring evidence

- 188 In response to the Cundall Valuation #2, ISPT tendered an expert report by Amanda Ring of SJB Planning. The Cundall Valuation #2 is based on the premise that a hypothetical buyer would not continue and maintain the improvements on the land but would instead continue the existing use by using the B-1 land as an open-air market, and develop part of the L-1 land other than in accordance with the heritage permit.
- 189 Ms Ring's report referenced amongst other things the existing planning controls under the Melbourne Planning Scheme, and the heritage

⁵⁸ Emails respectively dated 25 September 2017 and 26 September 2017 from David Sowinski, Manager, Visualisation, DELWP to Karl Cundall, tendered by ISPT after access to Mr Cundall's file.



registration and heritage permit. Essentially, her opinion is that, as at the relevant date of 1 January 2016:

- The development scenario that forms the basis for the Cundall Valuation #2 is not realistic or practical.
- The post-2003 additions were undertaken in accordance with the heritage permit and were purposefully designed as an integrated addition to the heritage building, not as a freestanding structure of independent design. This inter-connectedness is integral to the use of the building.
- If the post-2003 extension was considered to be stand-alone (as assumed by Mr Cundall), substantial remedial work would be required. Such an extension on part of the L-1 land would have required permission from Heritage Victoria and would likely have resulted in a reduced floor area if it is assumed that the B-1 land is vacant. It is not realistic that an addition on the northern part of the L-1 land could stand alone with an open, undeveloped forecourt to the south.
- The assumed use of the B-1 land as an open-air market is not realistic, given the purpose of planning controls for this site, which would anticipate and encourage a higher level of development. Mr Cundall's scenario would be a gross under-development of the land.

190 Although cross-examined, Ms Ring's opinion about the lack of planning viability of Mr Cundall's assumed development scenario was not materially challenged or undermined.

191 We accept Ms Ring's evidence. It follows that we again consider that there is no satisfactory underpinning for Mr Cundall's Valuation #2 from a planning perspective. His assumed scenario is not realistic or practical, and again seriously undermines his valuation evidence.

FURTHER CONSIDERATION OF VALUATION EVIDENCE

192 We have already summarised the main valuation approaches of Mr Brown and Mr Cundall and made a number of observations about the permissibility and/or appropriateness of their various valuation methods.

193 It will now be self-evident that, of the primary valuation methods before us, we are of the opinion that, in reality, only the Brown Valuation #1 is both permissible and acceptable in this proceeding as a basis for calculating the site value of the Melbourne GPO in accordance with s 2(8) of the VL Act.

194 We have nonetheless considered the expert valuer evidence in this section as a means of drawing together our overall conclusions, albeit in relatively summary form given what we have just said.



Cundall valuation evidence

Independence of Cundall evidence

- 195 In the course of cross-examining Mr Cundall, ISPT called for Mr Cundall's file. This revealed a course of correspondence between the Valuer General's office and Mr Cundall through which it appears that the Valuer General's office had sought to ascertain and influence Mr Cundall's support for a rent differential model.
- 196 In July 2017, Mr Cundall had prepared a report proposing a different valuation method for the valuation of the Melbourne GPO. In August 2017, the Valuer General's office specifically instructed Mr Cundall to consider a 'methodology outline' it had prepared (i.e. for a rent differential method) and sought his position on that. Four days later, Mr Cundall prepared an amended report to endorse the rent differential method, and three days later he was retained as the Valuer General's expert valuer in this proceeding.
- 197 In our opinion, Mr Cundall should have more transparently disclosed the basis for his retainer having regard to his duty as an expert witness in accordance with the VCAT practice note *PNVCAT2- Expert Evidence*.
- 198 The 'pre-vetting' of Mr Cundall by the Valuer General does not of itself affect Mr Cundall's specialist expertise in land valuation, to which we can still have regard. However, we agree with ISPT that it undermines Mr Cundall's independence as an expert witness and is relevant to the weight we should attach to his expert evidence in this proceeding.

Cundall Valuation #1

- 199 As we have indicated, Mr Cundall has conceded that his Cundall Valuation #1 is an approach that is 'novel', not known to be used or accepted in Victoria or elsewhere, different from the *Moneybox* cases and NSW approach, and not the subject of consideration in any valuation literature. We agree with ISPT that a cautious approach is therefore warranted.
- 200 From the 5-step approach we summarised earlier, it can be seen that Mr Cundall's primary method involves the calculation of the site value assuming no heritage constraints. A ratio is then calculated, based on the market rents that could be derived from the existing improvements, divided by the market rents that could be derived from the hypothetical maximum development of the land with no heritage constraints. The ratio is then applied to the unencumbered site value to derive the heritage-registered site value.
- 201 We consider, as a minimum, that Mr Cundall's approach is inappropriate on the following basis:
- Unlike Mr Brown's valuation approaches, the Cundall Valuation #1 is heavily dependent on existing rents as one part of the rent differential ratio. Mr Cundall conceded that his method does not work for vacant



land, and really only works for the assumptions in s 2(8)(a), but not for parts of the land to which s 2(8)(b) or (c) apply.

- The fact that Mr Cundall applied the assumptions in s 2(8)(a) alone to the whole of the land therefore renders his approach inappropriate for the Melbourne GPO site. The nature of any land covered by s 2(8)(b), and the assumption in that subsection, is such that there is no clear rent ‘differential’ that can be calculated under Mr Cundall’s model.
- Moreover, the assumptions made by Mr Cundall for the existing building under s 2(8)(a) cannot be applied to the L-1 land on the VHR Plan subject to s 2(8)(c) given the statutory assumption that the land can only be developed in accordance with the heritage permit, and given the assumption in s 2(8)(a) (i.e. that all improvements may be continued and maintained) does not appear in s 2(8)(c).
- Even for the B-1 land to which s 2(8)(a) of the VL Act applies, the Cundall Valuation #1 does not properly meet the assumptions under that sub-section because it does not correctly assume, for the purpose of calculating site value, that the land is unimproved. The ratio compares the rental returns of the heritage-registered Melbourne GPO *as improved*, with the rental returns of the land *as improved* and assuming its highest and best use unencumbered by heritage constraints.
- Further, the first step of Mr Cundall’s method involves the calculation of the unencumbered site value, based on its highest and best non-heritage use. This is at odds with the required assumption in s 2(8)(a)(i).
- Even to the extent the Cundall Valuation #1 does assume that the land is unimproved, it does not correctly factor in the constraints on a hypothetical purchaser on the future improvements that will be required, or in continuing and maintaining such improvements. The rent differential ‘ratio’ does not adequately reflect the reduced floor plate efficiency of the heritage-affected building and its consequential impost on costs, maintenance and outgoings.

202 In Mr Cundall’s view, there is simplicity in his approach as it doesn’t require the CIV to be calculated in order to derive the site value. That may be so, but we agree with Mr Brown that its application to a complex matter such as the Melbourne GPO land can result in an erroneous outcome.

203 The Cundall Valuation #1 is also based on flawed assumptions and inputs that materially overstate or undermine the site value he has calculated. These include the following:

- We agree with ISPT that the Cundall Valuation #1 involves a series of cumulative analyses and conclusions. It requires a large number of adjustments to two different sets of properties, the first being unencumbered properties used to derive a land value, and the second



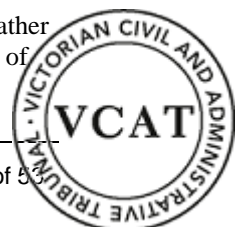
being used to derive a ratio reflecting the net rent differential, each of which has various subjective inputs that can materially change the valuation outcome.

- The highest and best use assumed by Mr Cundall is based on the DELWP ‘theoretical rebuild’ that ignores the assumptions in s 2(8). Under Mr Cundall’s model, the net effective rent is calculated on a theoretical rebuild unencumbered by heritage restrictions, with a substantially larger gross building area than the existing building⁵⁹. Mr Cundall’s approach appears not to accord with the assumptions in s 2(8)(a)(ii) and (iii) and requires a comparative assumption that does not accord with s 2(8)(a)(i).
- Under cross-examination, Mr Cundall was unable to justify his reliance on the DELWP ‘theoretical rebuild’ model if it used an uneconomic and non-viable assumed development, and thus produced an uneconomic rent.
- Mr Cundall’s approach is not supported by Mr Milner’s evidence. The derived gross building area of 32,000 m² above ground⁶⁰ is well beyond Mr Milner’s more realistic 20,000 m² to 24,000 m² range.
- Mr Cundall has derived a land rate of \$22,000/m² in order to calculate an unencumbered site value as his first step. This rate has been derived by analysing 14 sales between 2013 and 2016. However, amongst the many criticisms of these sales that we do not need to detail here, 12 of the sales appear to be within a different zone area with different planning constraints (e.g. no 40-metre height limit)⁶¹, and the sales are predominantly of land with residential development potential rather than the retail/commercial use of the Melbourne GPO.
- Moreover, as Mr Cundall conceded, he had not derived a gross floor area for these analysed sales, which may have provided a better basis for comparing the development potential of the land. When this was done (by Mr Brown), Mr Cundall conceded that the outcomes were out of kilter with his \$22,000/m² land rate for the Melbourne GPO land. As a ‘reality check’, this rate also does not sit well in comparison, for example, to the assessed site value of the adjacent (and non-heritage-registered) Myer building. We agree that the derived \$22,000/m² land rate is unreliable, which materially affects a

⁵⁹ In this way, Mr Cundall’s approach also differs materially from the NSW approach in the Moneybox cases, which initially compares the net rent of a building of *equivalent* size and use (to address the assumptions in the NSW s 14G), before accounting for possible improvements – see, for example, the summary of the approach in *Moneybox 3*, op cit, at [54] – [60]. Mr Cundall is effectively using a quite different denominator to calculate his rent differential ‘ratio’.

⁶⁰ Mr Cundall also allows for an additional 7,700 m² basement carparking but excludes this from his gross building area.

⁶¹ Most of the analysed sales are within the Capital City Zone - Schedule 1 (Non-Retail Core), rather than Schedule 2 of the Zone (Retail Core) in which the Melbourne GPO is situated. Only one of the analysed sales, at 248 Flinders Street, is within the same zone/schedule.



major input into Mr Cundall's model. If the derived land value was \$20,000/m², this would reduce the site value by \$2.7 million on this factor alone.

- Mr Cundall contended that his derived gross building area of 32,000 m² favours ISPT in his model. Whilst this may be the case, considered alone, in that the percentage the model uses to apply to the unencumbered site value may be more favourable to ISPT, it substantially inflates the unencumbered site value of \$84 million if the analysed land rate of \$22,000/m² is applied to the greater development potential of the larger building area.
- When assessing the net market rent of the existing use, Mr Cundall has had regard to the subject property's tenancy schedule in conjunction with other market rental evidence and applied a gross rent of \$7,216,757 per annum and then deducted outgoings (\$2,040,654 per annum) to arrive at a rounded net market rent of \$5,175,000 per annum. This provided an inflated net market rent compared to the existing rents used by Mr Brown. When Mr Cundall applied these rents in a revised calculation, this reduced the site value by \$1.8 million on this factor alone.

- 204 Given our opinion that the Cundall Valuation #1 fails at a more threshold level, we do not need to detail here a number of other omissions or adjustments that were called into question by ISPT, save to say that we generally accept the evidence in reply of Mr Brown on these matters. As the transcript of the hearing attests, Mr Cundall also made many concessions during a lengthy cross-examination. Many of these matters are recorded in ISPT's written submissions.
- 205 It follows that, even if Mr Cundall's rent differentiation approach is permissible and/or appropriate, the cumulative effect of the flaws or subjective assumptions in the Cundall Valuation #1 is such that his derived site value is unreliable. It is not for us to attempt to 'repair' the valuation.
- 206 Accordingly, it follows that we do not believe the Cundall Valuation #1 can be supported as a suitable basis for the contested valuation in this proceeding.

Cundall Valuation #2

- 207 Mr Cundall's second method was purportedly undertaken in an endeavour to give effect to all of the assumptions in s 2(8), including for the land covered by s 2(8)(b) and (c). It is not an amendment of his primary valuation, but a new approach – albeit without a detailed analysis. It was proffered after the commencement of the hearing, in a two-page letter with attached spreadsheets, and well after the valuers' conference and joint report.

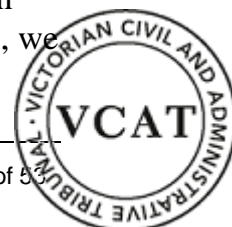


208 At a threshold level, we consider that the Cundall Valuation #2 is inappropriate as a valuation methodology for this land, for reasons including the following:

- The approach does not meet the assumption in s 2(8)(a) for the B-1 land on the VHR Plan (i.e. the land covered by the heritage-registered Melbourne GPO building). Mr Cundall assumes that a hypothetical purchaser would not propose to ‘continue and maintain’ any improvements on the land at all, but that this land will remain vacant and have no improvements. This approach relies upon the Valuer General’s alternative interpretation of s 2(8)(a)(ii) (with which we have earlier disagreed), which attempts to import into the provision a discretion whether the improvements ‘may’ be continued.
- To facilitate the ‘use’ being continued, albeit without improvements, Mr Cundall assumes that the B-1 land (possibly together with the L-1 laneway land) will be used as an open-air market, and that the rear L-1 land will be developed for a 3-4 storey retail/commercial use. These assumptions do not meet the requirements in either s 2(8)(a) or (c). Having regard to the planning evidence before us, we agree that the use for an open-air market would be a materially different use.
- The assumptions for the L-1 land also fail to have regard to the integration between the various parts of the land in terms of the existing use that must be assumed to continue.
- The assumptions for the L-1 land also fail to have regard to the totality of the heritage permit that constrains the potential for the assumed development of the land covered by s 2(8)(c). The heritage permit is also for an integrated development with other parts of the land, where integrated services and infrastructure cannot be easily separated for separate valuation exercises.
- When Mr Cundall was questioned by the Tribunal as to why he had valued the B-1 land as vacant land, his response was that this was part of his instructions. There was no reasoned basis for this position.
- None of Mr Cundall’s assumptions for the B-1 land and L-1 land are underpinned by planning evidence. As we have indicated, we prefer Ms Ring’s planning evidence about these matters.

209 Interestingly, although attacking Mr Brown’s use of a hypothetical development model as his primary valuation methodology for the whole of the land, the Cundall Valuation #2 essentially relies on a hypothetical development approach for the land covered by s 2(8)(c).

210 In similar fashion to the Cundall Valuation #1, we also consider that the Cundall Valuation #2 is based on flawed assumptions and inputs that materially overstate the site value that Mr Cundall has calculated. Given our opinion that the Cundall Valuation #2 fails at a more threshold level, we



again do not need to detail all of these matters⁶². Again, we generally accept the evidence in reply of Mr Brown on these matters, and note the many concessions made by Mr Cundall during cross-examination, several of which are also noted with relevant transcript references in ISPT's closing submissions.

211 By way of example:

- for the B-1 land, Mr Cundall analysed the same comparable sales as for his earlier valuation, and adopted an underlying land rate for the Cundall Valuation #2 of \$25,000/m²⁶³, to which he then applied a 90% adjustment to account for his assumed lack of development potential, giving an adjusted rate of \$2,500/m² (which is then multiplied by the land area to provide a site value for the B-1 land). Quite apart from other concerns about the analysed sales mentioned earlier, to our mind the need to adjust any valuation figure by as much as 90% suggests that the starting point is not comparable at all, or the outcome is arbitrary and/or unreliable.
- For the L-1 land, Mr Cundall assumes an average net rental of \$1000/m² of gross floor area for his assumed L-1 building. This is simply a valuer's assumption, with no clear foundation. Mr Brown has considered the actual tenancy schedules for the Melbourne GPO building for 2012-2014, in order to understand the rentals being achieved for separate tenancies in the L-1 part of the building (prior to the H&M tenancy of the integrated building). On this more sophisticated approach, Mr Brown considers Mr Cundall's average net rental of \$1000/m² to be overstated, and he instead calculates an average net rental of \$673/m². As will be seen, this factor alone significantly reduces the site value.

212 Interestingly, in his reply to the Cundall Valuation #2, Mr Brown attempted to test Mr Cundall's valuation approach by applying his (Mr Brown's) own assumptions – e.g. for the hypothetical development of the L-1 land but using Mr Grimes' construction costs estimates, treating the hypothetical sale as a going concern, applying his net average rental, and applying his relevant adjustments for holding costs, land tax and GST⁶⁴. A key difference arises in the gross realisation for the hypothetical development of the rear L-1 land, based on the capitalisation of Mr Brown's assumed net rent. Mr Brown's gross realisation is \$24,400,000 compared to Mr Cundall's \$58,000,000.

213 The consequence of Mr Brown's assumptions, applied to Mr Cundall's method, leads to a derived site value of \$1,700,000 for the L-1 land,

⁶² Numerous matters are set out in Mr Brown's reply document. For example, Mr Cundall has double counted the holding costs.

⁶³ It was not clearly explained why this differs from the \$22,000/m² land rate derived from the same sales for the Cundall Valuation #1.

⁶⁴ We have not detailed all of the adjustments in this summary of Mr Brown's approach. All relevant adjustments are set out in his report.



compared to Mr Cundall's \$20,100,000 (later amended to \$19,280,000). This demonstrates how sensitive Mr Cundall's valuation outcome is to his own subjective inputs. Accepting (for the purpose of this scenario) Mr Cundall's site value for the B-1 land of \$6,987,500⁶⁵, Mr Brown assesses the overall site value of the land at \$8,687,500 (i.e. \$1,700,000 + \$6,987,500), compared with Mr Cundall's \$26,372,982 (i.e. \$7,027,500 + \$19,280,482), which Mr Cundall rounded to \$26,375,000.

- 214 Moreover, as an additional exercise, Mr Brown assessed a gross realisation for the L-1 area excluding any land tax that would be payable on the B-1 land, on the basis of his opinion that the B-1 land has no real value under Mr Cundall's scenario. This led to an assessed overall site value of \$3,600,000, again compared to Mr Cundall's \$26,375,000.
- 215 Mr Brown's 'testing' of the Cundall approach was not materially undermined during cross-examination. We believe Mr Brown's assumptions are generally underpinned by better evidence or a more sophisticated analysis than those of Mr Cundall. Even allowing for some legitimate difference of opinion about some valuation assumptions 'on the margin', Mr Brown's testing of Mr Cundall's valuation methodology demonstrates how sensitive the Cundall Valuation #2 is to Mr Cundall's relatively subjective inputs.
- 216 It follows that, even if permissible, we consider that the cumulative effect of the flaws or subjective assumptions in the Cundall Valuation #2 is such that his derived site value is unreliable. Accordingly, in our opinion, the Cundall Valuation #2 cannot be supported as a suitable basis for the contested site valuation in this proceeding.

Brown Valuation evidence

- 217 It will already be apparent that we consider the Brown Valuation #1 is an appropriate valuation method for the assessment of site value in this proceeding.
- 218 We make the following additional comments arising from Mr Brown's evidence.

Completeness of Brown evidence

- 219 As indicated earlier, the Brown Valuation #1 and Cundall Valuation #1 had been prepared without the benefit of the VHR Plan for the Melbourne GPO land, a time when it was not well understood that the land was comprised in a number of parts to which the different assumptions in s 2(8)(a), (b) and (c) of the VL Act applied.

⁶⁵ This \$6,987,500 was the value initially given by Mr Cundall for the B-1 land in his first iteration of the Cundall Valuation #2, which formed the basis for Mr Brown's reply. Mr Cundall later revised this figure to \$7,027,500 – the amount we have set out earlier in these reasons. The difference is immaterial for present purposes.



- 220 The Cundall Valuation #2 was subsequently prepared by Mr Cundall to deal with this issue. However, there was no further valuation exercise formally undertaken by Mr Brown, and this led to some discussion about the extent to which his initial valuation (i.e. the Brown Valuation #1) could still be relied upon.
- 221 Although not undertaking a further formal valuation, Mr Brown prepared a supplementary report⁶⁶ through which he indicated essentially that, given the nature of the hypothetical development approach, the application of the assumptions in all of s 2(8)(a), (b) and (c) did not affect his underlying analysis, nor his ultimate valuation conclusion. It still led to a nil site value on a similar basis. Mr Brown also gave oral evidence to similar effect.
- 222 We are satisfied that the Brown Valuation #1, supplemented by this additional evidence, can be relied upon as meeting all of the relevant assumptions in s 2(8)(a), (b) and (c) of the VL Act.

Brown Valuation #1

- 223 We have already summarised the assumptions in the Brown Valuation #1 earlier in these reasons. Essentially, it comprises an orthodox hypothetical development approach save that the 'hypothetical development' equates with the existing improvements and use of the land in order to meet the assumptions in s 2(8) of the VL Act.
- 224 We accept Mr Brown's opinion that, for the site value of *this* land, a hypothetical development approach is appropriate given that there are no comparable sales (i.e. no vacant sites with a heritage listing).
- 225 We accept Mr Brown's opinion that, although s 2(8) requires the valuation to be calculated on the basis of assumptions applying to different parts of the land, this does not require an outcome where different parts of the land are each valued quite separately, and then aggregated. The valuer should properly have regard to the integration between the various parts of the land and built form in the assessment of the overall site value, provided this is done having regard to the relevant statutory assumptions. The land being valued has one title and comprises one property with one significant and integrated development, and needs to be considered in this context.
- 226 We have previously noted the level of integration across different parts of the land in terms of built form, infrastructure, services and use, and this was made quite evident on our accompanied site visit. It is also represented pictorially earlier in these reasons. Some of this integration arises under the specific terms of the heritage permit that applies to both the B-1 land and L-1 land, such that it is difficult and inappropriate to try to value these parts separately.
- 227 In terms of the specific calculations made by Mr Brown about net rents, capitalisation rates, holding costs, interest, selling costs etc. in his

⁶⁶ Report dated 23 July 2018, TB 1267



hypothetical development model, none of these were materially challenged by the Valuer General. To be fair, the Valuer General largely accepted that, *if* the hypothetical development approach was preferred or adopted in this proceeding, Mr Brown's actual valuation assessment under that approach was sound.

228 We accept Mr Brown's evidence concerning the Brown Valuation #1. His approach is preferred because:

- It is consistent with all of the assumptions in s 2(8)(a),(b) and (c) of the VL Act have been considered in the valuation.
- The highest and best use has been restricted to the existing use.
- The *actual* permit provisions in the heritage permit have been considered, including the integration between the existing and the new building.

Check methods – the Brown Valuation #2 and Brown Valuation #3

229 We think it important that the Brown Valuation #1 can also be supported, in part, because it is capable of being checked through other commonly used valuation methods⁶⁷.

230 As we have indicated, Mr Brown uses two check methods. Both are based on an assessed capital improved value of \$81,500,000, derived from gross rents less outgoings, capitalised at 5.5%, and adjusted for capital expenditure. Although the CIV is not under review in this proceeding (and the Council value of \$71,334,000 therefore stands as the statutory assessment), Mr Brown has separately assessed the CIV based on a capitalisation of actual net rents.

231 The capitalisation rate of 5.5% was chosen by Mr Brown, in part, based on comparable sales of improved land. Mr Brown assessed 3 sales with 2 of these (206 Burke Street and the Block Arcade) considered to be the most comparable due to their close proximity, retail use with upper level office use, and the Block Arcade's listing on the Victorian Heritage Register. The analysed sales evidence reflected a market yield of between 5.3% and 5.9%, and a direct comparison analysis of between \$7,696/m² and \$10,170/m². This analysis was not challenged, and we accept it within the context in which it was undertaken.

232 This assessment of CIV was undertaken by Mr Brown because the CIV is a component of his two check methods. His higher assessed CIV (i.e. \$81,500,000, rather than the Council's \$71,334,000) also means that his derived site value (i.e. CIV less depreciated costs, or CIV less replacement cost) will be higher, and his approach in this regard was not challenged.

⁶⁷ We say this subject to the partly unresolved debate about the application of the principle in *Tooheys* in Victoria to Mr Brown's check methods, a matter we have discussed earlier and do not need to finally decide here.



We consider this to be entirely appropriate and provides added rigour to Mr Brown's valuation assessment.

- 233 The Brown Valuation #2 is based on CIV less the depreciated costs of development. This was Mr Brown's least favoured method. It also returns a derived value that is negative, leading to a nominal site value of \$1.
- 234 This valuation approach has its limitations and would likely not be appropriate as the primary method of valuation for the Melbourne GPO. The assumptions made about a depreciation rate are subjective, and highly influence the valuation outcome. Moreover, here, it requires the depreciation to be assessed for both the original and new buildings, with different rates applied. Small adjustments to the depreciation rate significantly effects the end result.
- 235 Mr Brown acknowledged this and provided a sensitivity analysis with a number of variations. His main calculation is based on depreciation rates of 15% for the new building and 40% for the old GPO building, leading to a derived land value of minus \$94,860,000. If the rates were lower (e.g. respectively 5% and 25%), the derived land value would be minus \$137,050,000. If the rates are much higher (e.g. respectively 35% and 70%), the derived land value would be minus \$10,490,000. Whilst we do not necessarily agree with the adopted depreciation rates applied, we accept that the results of the sensitivity analysis all conclude a negative derived land value, and thus a nominal site value of \$1. To deduce a positive site value would require a blended depreciation rate in excess of 70%. We agree with Mr Brown that this would be unrealistic, but it perhaps also exposes why this check method is not ideal.
- 236 The Brown Valuation #3 is based on CIV less the replacement cost of improvements. This leads to a derived land value of minus \$205,380,000, and thus a nominal site value of \$1. Can
- 237 As we indicated earlier in these reasons, we agree with the Valuer General that the '*value* of improvements' is not the same as the *cost* of those improvements. However, in the absence of comparable sales, we agree with Mr Brown that a reference point that equates the added value of improvements to their cost is appropriate.
- 238 Mr Brown was not challenged on his particular assumptions or calculations for either check method. We accept his evidence in the context in which it was given. Both check methods are a useful exercise but, given the limitations of each method, we do not need to rely materially on either of them or give them determinative weight. They serve to bolster the view we have reached about the Brown Valuation #1 rather than being primary methods in their own right.



CONCLUSIONS

Conclusion in this proceeding

239 It follows from all of the above that:

- We consider that the Brown Valuation #1 is legally permissible. Although not necessarily ‘ideal’ for the valuation of a heritage-registered site under s 2(8) of the VL Act, in the absence of comparative sales a hypothetical development method is a permissible approach to the calculation of site value.
- Mr Brown has properly applied the hypothetical development method and, apart from challenging the use of such approach generally, the Valuer General did not attack Mr Brown’s assessment under that approach.
- The Brown Valuation #1 provides for an acceptable and ‘preferred’ site valuation for the Melbourne GPO as at 1 January 2016 on the particular evidence and submissions before us.
- Although not determinative, we consider that the Brown Valuation #1 is supported by Mr Brown’s check methods.
- Conversely, we consider the Cundall Valuation #1 and the Cundall Valuation #2 to be inappropriate and/or flawed for the reasons we have set out.

240 Accordingly, the decision of the valuation of site value is set aside in relation to site value. In its place, the site value is substituted to be \$1.

Observations on the desirability of legislative clarification

- 241 We said at the outset that we would make some observations on the desirability for reform or clarification of s 2(8) of the VL Act. The provision has now been a source of industry debate for several years.
- 242 At the very least, s 2(8) is inelegantly drafted by modern standards. It is difficult to apply in practice given its reliance upon artificial assumptions, with potentially different assumptions applying to different parts of a site. In our opinion, the provision has become anachronistic. It is forcing parties into complex and costly litigation about the artificiality of a contrived valuation that bears no resemblance to the market or the real-world when the underlying dispute is really about land tax. It is also leading to inconsistent outcomes for different land, and quite different approaches in different states.
- 243 It is not for us to promote a particular policy outcome about the extent of land tax that should be payable for land containing a heritage-registered building. That is a matter for legitimate debate between the government, the property industry, and the broader community. As an administrative tribunal sitting in a review jurisdiction, we must simply endeavour to interpret and apply the law as it stands.



244 However, if s 2(8) is to be retained within the VL Act, we think it should be clarified so that its intent and application is clear. If it is intended to promote or negate a particular valuation methodology, then that should also be made clear. Alternatively, the valuation of heritage-registered land could possibly be simplified on some other basis – e.g. as a multiple of NAV or percentage of CIV. Or s 2(8) could even be repealed so that the site value of heritage-registered land is calculated on a similar basis to all other land, and with a waiver or proportionate reduction in land tax dealt with in some other and more transparent way – e.g. in the *Land Tax Act 2005* itself. As we have said, we have no particular interest in the outcome, save to avoid what we see as complex and costly litigation in the land valuation list at VCAT that is not addressing the real and underlying dispute between the parties in the valuation of heritage-registered land.

Mark Dwyer
Deputy President

Justine Jacono
Senior Member

