UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – VALUATION – modern headquarters office building let in "Category A" condition before fitting out by tenant to "Category B" – whether rateable value increased by tenant's fitting out works – whether statutory decapitalisation rate to be used when analysing rental value of fit out – appeal allowed – rateable value determined at £1 million

AN APPEAL AGAINST A DECISION OF
THE VALUATION TRIBUNAL FOR ENGLAND

BETWEEN:

DAWN BUNYAN
(VALUATION OFFICER)

Appellant

-and-

ACENDEN LIMITED

Respondent

Re: Ascot House,
Maidenhead Office Park,
Maidenhead,
Berkshire SL6 3QH

Martin Rodger KC, Deputy Chamber President
and
Mr Peter D McCrea FRICS FCIArb

Hearing dates: 1-3 November 2022

Jenny Wigley KC and *Sarah Sackman,* instructed by HMRC Solicitors, for the appellant
Cain Ormondroyd and *Horatio Waller*, instructed by Osborne Clarke LLP, for the respondent

The following cases are referred to in this decision:

Allen (VO) v English Sports Council [2009] RA 289
Allen (VO) v Freemans plc [2009] UKUT 240 (LC)
Berry (VO) v Iceland Foods Ltd [2015] UKUT 14 (LC); [2015] RA 201
Dorothy Perkins Retail Ltd v Casey [1994] RA 391
Edma (Jewellers) Ltd v Moore (VO) (1975) RA 343 (LT)
FR Evans (Leeds) Ltd v English Electric Co Ltd (1977) 36 P & CR 185
Fir Mill Ltd v Royston UDC (1960) 53 R & IT 389
Godbold v Martin The Newsagent [1983] 2 EGLR 128
Hewitt (VO) v Telereal Trillium [2019] UKSC 23
Hughes (VO) v Exeter City Council [2020] UKUT 0007 (LC)
Hughes (VO) v York Museum and Gallery Trust [2017] RA 302
Imperial College of Science and Technology v Ebdon (VO) [1984] RA 213
Lambert v Woolworth [1939] Ch 883 CA
Morrison EF (GP) Limited v Assessor for Central Scotland [2004] RA 76
Williams (VO) v Scottish & Newcastle Retail Ltd [2001] RA 41

Introduction

1. Modern high quality office buildings are usually offered to the letting market in a "Category A" condition. If the building has been newly constructed or recently refurbished, its owner will typically have installed raised floors and suspended ceilings, basic mechanical and electrical services including lighting and air-conditioning, a fire detection system and basic internal finishes. By marketing the building in this condition, the owner will hope to generate interest from the widest range of potential occupiers. Once a letting has been achieved, the new tenant will be free to fit the building out to meet its own requirements. The tenant's fitting out work will bring the building into a "Category B" condition and is likely to include the installation of kitchens and tea points, partitioning, the re-routing of air-conditioning and power points to accommodate its preferred layout, and the addition of IT infrastructure.

2. This appeal concerns the value for rating purposes of an office building in Category B condition.

3. The principal contention of the respondent ratepayer is that the additional Category B works carried out by a tenant to render a high-quality office building capable of beneficial occupation make no difference whatsoever to the building's rateable value. That rateable value can therefore be ascertained substantially by reference to the rent and other financial terms agreed between the building owner and the incoming tenant when it was let in its Category A condition.

4. £3.4 million was spent by the ratepayer in this case on fitting out Ascot House, a building on the Maidenhead Office Park at Westacott Way outside Maidenhead. To the appellant Valuation Officer (VO) the proposition that the expenditure of such a substantial sum of money to make the building fit for occupation has added not a single penny to its rateable value is illogical and impossible of acceptance.

5. Ascot House was originally entered in the 2017 rating list as "offices and premises" with a rateable value of £1,110,000 with effect from 1 April 2017. The ratepayer challenged that entry, but the VO confirmed the original rateable value. The ratepayer appealed to the Valuation Tribunal for England (VTE) on the grounds that the valuation was unreasonable. On 4 August 2021 the VTE issued a decision substituting a rateable value of £875,500. That valuation was largely based on the rent at which the building had been let in Category A condition and made very little allowance for the ratepayer's Category B fit out. The VO now appeals the VTE's decision.

6. At the hearing of the appeal the VO was represented by Ms Jenny Wigley KC and Ms Sarah Sackman, and the ratepayer by Mr Cain Ormondroyd and Mr Horatio Waller. Expert evidence was given on three topics: on building costs by Mr Stephen Jones MRICS for the VO and by Mr Andrew Jones FRICS for the ratepayer; on the operation of the office market by Mr Michael Brankin OBE MRICS and Mr Malcolm Kempton FRICS; and on valuation by Mr Aiden Bailey MRICS and Mr Blake Penfold FRICS. We are grateful to all who participated for their assistance.

7. After the hearing we undertook an unaccompanied inspection of Maidenhead Office Park, viewing Ascot House externally (it has been subdivided and refurbished since the material day) as well as Osprey House, which also featured in the evidence. We also inspected, again externally, the main comparables in Maidenhead, Woking, Guildford and Leatherhead.

The appeal property

8. The Maidenhead Office Park is located 4 miles west of Maidenhead town centre. Access is from the A4 Bath Road by way of Westacott Way. The location was described by Mr Penfold as having a rural feel and it is certainly remote from the town centre and its facilities.

9. The Park was formerly the site of a trading estate which was redeveloped in the 1990s as the headquarters campus of a multi-national corporation. Ascot House was completed in 1996 as part of that campus development, but in 2009 the owner filed for bankruptcy and the campus was split up. Ascot House was then acquired by a Swedish pension fund which carried out a substantial refurbishment between 2013 and 2015 at a cost of £3 million.

10. The building was designed to be capable of being sub-divided and let as two separate units and comprises a pair of conjoined quadrangles, each surrounding its own central light well. Its net internal area of 4,718m^2 is split almost equally between the ground and first floors. Adjoining the building are 105 car parking spaces which are let with it and are agreed to form part of the same hereditament for rating purposes.

The letting to the ratepayer

11. Ascot House was let to the ratepayer, without payment of a premium, on 12 October 2015 for a term of 11 years from 1 September 2015 at an annual rent of £1,123,375. The parties agreed a rent-free period of 15 months from the term commencement date. Rent was payable at half rate from 1 December 2016 and at full rate from 1 August 2017.

12. The lease is on standard institutional full repairing and insuring terms, with the tenant also contributing a fair proportion of the cost of repairs and maintenance to estate roads and other estate facilities. The building may be sublet in whole or in parts, subject to consent. At the expiry of the term the tenant is required to remove any alterations or additions or other works before yielding up the premises to the landlord. The rent is subject to five yearly rent reviews to open market level, excluding any increase in value attributable to tenant's improvements.

13. The lease also includes a tenant's option to break, without penalty, on 1 September 2021 (that is to say after six years) on nine months prior notice. If the break was not exercised, the tenant benefitted from a further three-month rent-free period. In the event, the ratepayer remained in occupation of the building until late 2020, when it agreed a surrender of the lease and took back a lease of the ground floor only. The landlord then marketed the first floor in its Category B condition, without achieving a letting.

14. The parties agree that when Ascot House was let in 2015 it was in a reasonable Category A condition. The ratepayer then fitted the building out to suit its own style of occupation. We

assume that at some point the parties entered into a formal agreement allowing the ratepayer to carry out those works either in the form of a licence or a prior agreement for lease, but no such document was put in evidence and no one with personal knowledge of the facts gave evidence.

15. The ratepayer's preferred style of occupation required a largely open plan layout with only a limited allocation of partitioned space. Its works to the building included: installing plasterboard and stud partitioning to form meeting rooms, a data centre with a dedicated electricity supply and fire detection system, a post room and a recreational studio, all with timber doors and other necessary treatments; installing showers, storage areas and tea points with cupboards and fittings; supplementary air-conditioning units, extra sockets and repositioned lighting; IT infrastructure; a CCTV installation and a kitchen and canteen area.

16. The ratepayer's total expenditure on the building (including furnishings and other non-rateable items) was around £3.4 million. The parties agree that £1.6 million of that expenditure was on alterations and fit-out to the building itself which would be capable of being utilised by another occupier. The rest of the cost was incurred on furniture and equipment which would be taken away by the ratepayer at the end of the lease, or on bespoke items for which the ratepayer had a requirement but which are agreed would be of no general use to other occupiers. There was a dispute about how much of the £1.6 million spent on alterations and fit-out capable of being utilised by another occupier would have had what was referred to as "general market appeal" and whether a different occupier would be prepared to pay rent for them, but there was no disagreement about the condition of the building on the material day – it was fitted out to a Category B specification. For the purpose of valuation, it is assumed to have been in that condition, vacant and to let, in a reasonable state of repair and with all the ratepayer's chattels having been removed.

The rival valuations in outline

17. The VO arrived at her valuation in the following three stages:

    1. The terms of the October 2015 letting of Ascot House in its unfitted, Category A condition were first analysed to arrive at an "effective rent" i.e. a sum equivalent to the annual sum which it is assumed would have been payable from the commencement of the term if no rent-free period had been agreed. The parties agreed that this effective rent was £165.98 per sqm if analysed over the period to the 2021 lease break, or £184.39 per sqm if analysed to the end of the term in 2026.

    2. The effective rent was then adjusted to take account of the ratepayer's Category B fit out works which had been added by the material day and which were not exclusively of value to the ratepayer itself. This was done by amortising the agreed £1.6 million cost of those works and adding the resulting figure to the effective rent agreed for the building in Category A condition.

    3. The adjusted figure was then taken into account together with evidence of rents agreed for comparable lettings of buildings let in Category A condition, and rents agreed for other fitted out offices in Category B condition (a mixture of sub-lettings, rent reviews

and lease renewals). From this evidence the VO derived a tone for Category B offices in Maidenhead of £230 per sqm. Applying this tone to Ascot House produced a rateable value of £1,110,000.

18. The respondent's case was that the rateable value of Ascot House was £810,000, equivalent to £166 per sqm (rather lower than the VTE's figure of £875,000, or £180 per sqm). This figure was arrived at by asking two questions:

    1. Did the ratepayer's works to Ascot House make it more valuable when considered vacant and to let as required by the statutory valuation hypothesis?

    2. If so, by how much did they increase the value of Ascot House?

20. The respondent's answer to the first question it posed was supplied by Mr Kempton, its expert on the Maidenhead office market. He considered that expenditure on works which were specific to the requirements of a particular tenant and which lacked any wider appeal would not materially affect the letting value of a top-class office building. He further considered that prospective tenants in the market for a building of the size and quality of Ascot House would expect to carry out their own bespoke fit out works, based on their own requirements. The presence of Category B fit out works designed to meet the needs of some other occupier would therefore make the premises less attractive in the market rather than more attractive. Mr Penfold, the respondent's valuation expert, agreed with Mr Kempton's propositions, at least on a theoretical level. He was also unable to detect in the various transactions relied on by the VO any substantial evidence that a letting of a building comparable to Ascot House in Category B condition would command a higher rent than a letting of the same building in Category A condition.

21. For these reasons the respondent's experts answered no to the first question and Mr Penfold based his primary valuation on the agreed letting of Ascot House at an effective rent of £166 per sqm rate (analysing the rent-free period up to the break date).

22. If the answer to the first question was found by the Tribunal to be yes, Mr Penfold offered an alternative valuation arrived at by making an addition to his original figure to reflect the value of the tenant's works, costing £1.6 million, which it was agreed would be of some general utility to occupiers other than the respondent. The appropriate way to determine the amount of that addition, in Mr Penfold's view, was to apply the statutory decapitalisation rate of 4.4% to the agreed cost of those items. That represented an addition of £15.07 per sqm and produced a rateable value of £880,000.

23. Each expert's valuations included an agreed addition for car parking of £26,250.

The statutory valuation framework

24. There was no disagreement about the parameters of the required valuation. In accordance with paragraph 2(1) of Schedule 6 to the Local Government Finance Act 1988 the rateable value of Ascot House is an amount equal to the rent at which it is estimated the hereditament

might reasonably be expected to let from year to year on a date which is agreed to be 1 April 2015 (the antecedent valuation date, or AVD), on the assumption that the property is in a state of reasonable repair when let and on the basis that the tenant undertakes to pay all usual tenant's rates and taxes and to bear the cost of the repairs, insurance and other expenses necessary to maintain the property in a state able to command that rent. By paragraph 2(6) and (7)(a) of Schedule 6 matters affecting "the physical state or physical enjoyment of the hereditament are taken to be as they were on 1 April 2017 (the 'material day', which is the date on which the 2017 rating list came into effect). Subject to that qualification, all matters capable of affecting the valuation are to be taken to be as they really were on the AVD.

25. In *Hewitt (VO) v Telereal Trillium* [2019] UKSC 23, at [7], Lord Carnwath explained how a valuer was to estimate the rent at which the hereditament might reasonably be expected to be let:

> "In short, the valuer must imagine a hypothetical negotiation between a willing landlord and a willing tenant and arrive at the rent which best represents the resulting compromise:
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> > "You must assume a landlord willing to let, and a tenant willing to take by the year; and having done so, you must get in the best way you can at the rent which, under an agreement brought about by the compromise of the conflicting interests of the man who wants to receive as much as he can and the man who wants to pay as little as he can, would be arrived at under such circumstances." (*Smith v The Churchwardens and Overseers of the Poor of the Parish of Birmingham* (1888) 22 QBD 211, 219 per Wills J)
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> In similar terms in *Robinson Bros (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee* [1937] KB 445, 470, Scott LJ said:
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> > 'The rent to be ascertained is the figure at which the hypothetical landlord and tenant would, in the opinion of the valuer or the tribunal, come to terms as a result of bargaining for that hereditament, in the light of competition or its absence in both demand and supply, as a result of 'the higgling of the market'. I call this the true rent because it corresponds to real value.'"

26. The notional letting is to be assumed to be on the basis that the use to be made of the hereditament will be within the same mode or category of occupation as the ratepayer's actual use. The hypothetical tenant is not required to put out of its mind the possibility that "minor alterations of a non-structural character" might make the premises more suitable for its occupation and use without changing the general mode or category of that use (*Fir Mill Ltd v Royston UDC* (1960) 53 R & IT 389, a decision of the Lands Tribunal approved by the Court of Appeal in *Williams (VO) v Scottish & Newcastle Retail Ltd* [2001] RA 41 at [74]-[78]). These "minor alterations" could include "a fair amount of 'rebranding' in fascias and fittings appropriate to the same category of business" (*Scottish & Newcastle* at [75]).

27. The parties to the hypothetical negotiation are taken to be willing to transact on the assumed terms for the property in its assumed condition. There is no question of the tenant being reluctant to take the tenancy or requiring an inducement to persuade it to do so despite the property not being suitable for its purposes. In *FR Evans (Leeds) Ltd v English Electric Co*

Ltd (1977) 36 P & CR 185, Donaldson J explained that a valuation requires that there be imagined:

> "a hypothetical person actively seeking premises to fulfil needs which these premises could fulfil. … He is a willing lessee and is quite prepared to take the subject premises at the right price."

The valuation of fitting out works

28. It is commonplace that after agreeing a rent for premises a tenant may then spend more of its own money in fitting them out. When valuing for rating purposes the reality principle requires that the hereditament be valued in its actual condition on the material day (subject to the assumption that it is vacant and in a reasonable state of repair). In the absence of some specific statutory justification for attributing no value to a particular feature, everything which forms part of the hereditament must be valued, irrespective of who provided it.

29. No statutory provision generally excludes the value of fitting out by a tenant from being taken into account in determining rateable value. Where the value of some specific feature is required to be disregarded it is by way of exception to the general direction to take account of matters affecting the physical state or physical enjoyment of the hereditament as they were on the material day; one example of such an exception is the requirement to disregard the value of process plant or machinery which belongs to any of the classes set out in the Schedule to the Valuation for Rating (Plant and Machinery) Regulations 1994.

30. A well-known example of the general principle that a tenant's fitting out works are to be taken into account in a rating valuation is *Edma (Jewellers) Ltd v Moore (VO)* (1975) RA 343 (LT). In that case the ratepayers took a tenancy of shop premises in an arcade; they were obliged by their lease to fit the shop out at their own expense within three months, including installing a shop front. When it came to assessing the rateable value of the premises it was not disputed that the ratepayers' expenditure on fitting them out should be taken into account. The dispute was over how that capital expenditure should be amortised to arrive at an annual equivalent which could be added to the rent reserved by the lease to give the rateable value.

31. The Lands Tribunal (Mr J H Emlyn Jones FRICS) began by addressing the purpose of the exercise, at p.350:

> "It is perhaps helpful to consider what the valuer is trying to do in carrying out this exercise. The objective is the determination of the rent which a tenant might reasonably be expected to pay under the rating hypothesis in those cases where the tenant under an actual lease carries out certain capital expenditure on the landlord's hereditament. It is proper to assume that the gross value is higher than the amount of rent reserved under the lease. An analysis of that expenditure has as its purpose the ascertainment of the amount by which the rent reserved is to be increased in order to become equivalent to the gross value. On the one hand it would appear reasonable to assume that, if a tenant is prepared to pay for the benefits of occupation of the hereditament, partly by way of rent and partly

> by way of capital expenditure, he would also be prepared to pay the same amounts calculated in annual terms. By thus taking the equivalent cost to the tenant it is possible to arrive at the "virtual" rent which he, the actual tenant, would be prepared to pay. On the other hand, it is also possible to say that not all the expenditure by the tenant necessarily improves the value of the landlord's hereditament in the market, vacant and to let. To the extent that it does not, then clearly there is no increase in the gross value. Furthermore in considering the virtual rent, it becomes necessary to examine closely the facts of each case, in order to appreciate the value of the expenditure to the actual tenant; and this must involve an attempt to understand his thinking and his expectations at the time when he undertakes to carry out the expenditure. It seems to me, therefore, that all the expenditure must be looked at on its merits when considering the formula to be used in converting capital sums to their annual equivalents."

32. The Lands Tribunal (HHJ Marder QC, President) adopted a similar approach in *Dorothy Perkins Retail Ltd v Casey* [1994] RA 391, which concerned an air conditioning system installed by the ratepayer in a retail shop. There was no evidence of the effect on market rents of the presence of air conditioning. On behalf of the ratepayer it was argued that it was not the practice of landlords to install air conditioning, and that the sort of retailer who would be interested in the hereditament would regard the fixtures and fittings of a previous tenant as being of no value to it. The Tribunal was not persuaded, saying (at p.411) that it was clear that air conditioning conferred a benefit on the occupying retailer, before continuing:

> "That is why the installation of air conditioning is now commonplace, and why the majority of incoming tenants are prepared to incur the expense of installation as an element of fitting out, as did the ratepayers themselves…It is difficult to conceive of a hypothetical tenant, faced with the choice of two shop units vacant and to let, one with an effective air conditioning system and the other without, who would not pay more for the acknowledged benefit of the air conditioning system."

33. For the purpose of this appeal it is notable that in both *Edma (Jewellers)* and *Dorothy Perkins* the Tribunal was prepared to assume that the tenant's expenditure had increased the rent at which the hereditament could reasonably be expected to be let because a tenant would be prepared to pay more for premises which were already fitted out. That proposition was one which in both cases the Tribunal regarded as obvious, so that the only question was by how much the rental value of the premises had been increased.

34. *Edma (Jewellers)* and *Dorothy Perkins* both concerned the treatment of fitting out work in the context of valuation for rating. It is convenient at this stage also to refer to the treatment of tenant's fitting out and improvements in two other contexts which featured in the evidence, namely, on the renewal of business tenancies under Part II of the Landlord and Tenant Act 1954, and in the context of contractual rent reviews.

35. On the renewal of a business lease under Part II of the Landlord and Tenant Act 1954, the rent at which the new lease is to be granted is determined in accordance with section 34 of the Act. In the absence of agreement, the rent is to be such as having regard to the terms of

the tenancy the holding might reasonably be expected to be let in the open market by a willing lessor. In making that assessment there is to be disregarded (amongst other things) any effect on rent of certain improvements identified in section 34(2). Those improvements are:

> "… any improvement carried out by a person who at the time it was carried out was the tenant, but only if it was carried out otherwise than in pursuance of an obligation to his immediate landlord and either it was carried out during the current tenancy or the following conditions are satisfied, that is to say, -
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> (a) that it was completed not more than twenty-one years before the application for the new tenancy was made, and
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> (b) that the holding or any part of it affected by the improvement has at all times since the completion of the improvement been comprised in tenancies of the description specified in section 23(1) of this Act; and
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> (c) that at the termination of each of those tenancies the tenant did not quit."

36. Although the term "improvement" is used in section 34(2) and in a number of other statutes concerning the rights of landlords and tenants, it is not defined. In a case under the Landlord and Tenant Act 1927 the Court of Appeal supplied an explanation which has been generally applied, namely, that an improvement is any work of physical alteration which, from the tenant's point of view, improves the holding (*Lambert v Woolworth* [1939] Ch 883, CA).

37. The simplest case in which section 34(2) is applied is where the improvement was carried out during the "current tenancy" (i.e. the tenancy which is being continued by the 1954 Act at the time the required valuation is being undertaken). In such a case the effect on rent of all tenant's improvements will be disregarded except where the improvement was carried out in pursuance of an obligation to the tenant's immediate landlord. Such an obligation may be included in the tenancy agreement itself, in a prior agreement for lease, or in a licence to carry out improvements (although in the case of a licence it is necessary to distinguish between an obligation to undertake works and a simple permission, and only the latter will prevent the works from being disregarded: *Godbold v Martin The Newsagent* [1983] 2 EGLR 128).

38. Where premises have been fitted out by a tenant it may be difficult, in the absence of proper evidence, to know whether the rent which was agreed on a renewal of the tenancy under the 1954 Act took account of the presence of the tenant's improvements, or not. It will often be unclear whether the improvements were carried out in pursuance of an obligation to the tenant's immediate landlord. If they were, they should have been taken into account in determining the rent; if they were not, they should have been disregarded.

39. A similar picture applies to the treatment of improvements under contractual rent review clauses in leases. There is no standard form of commercial rent review clause but a well drafted clause will almost invariably specify that the effect on rent of improvements carried out by the tenant is to be disregarded, and will often assume that the premises are fitted-out and capable of beneficial occupation. Often the disregard of tenant's improvements is qualified by an exemption of work carried out pursuant to an obligation to the landlord, since

it will be assumed that the value of the tenant's works will have been taken into account in agreeing the financial terms of the transaction, including the amount of the rent or of any capital contribution, or the length of any rent-free period. As regards modern offices, without a proper understanding of the circumstances it will be difficult to know with any confidence whether the rent agreed or determined on the rent review reflects the value of the premises in their fitted-out condition or in a previous shell or Category A condition.

The evidence of the market experts

40. Evidence on the office letting market in Maidenhead was given by Mr Kempton on behalf of the ratepayer and Mr Brankin for the VO. The focus of this evidence was the attitude which would be taken by the market to a building which was already fitted out to Category B standard.

41. Mr Kempton's thesis was that prospective tenants in the office market would not pay more for a class A headquarters building which had been fitted out to Category B standard than they would for a building finished to Category A standard, nor would landlords expect to achieve any higher rent. In his written evidence he summarised his "strong opinion that the office market simply would not pay more for an office of this type due to a Category B fit-out."

42. Mr Kempton is an experienced Chartered Surveyor based in Maidenhead and familiar with the local market. His evidence could therefore have been of considerable relevance to the issue we have to determine. Unfortunately, he was a noticeably partisan witness who repeatedly shied away from answering direct questions if the answers risked being unhelpful to the ratepayer. It was only at the end of his oral evidence, and in response to a question from the Tribunal, that he addressed the central issue without evasion. He then acknowledged that a tenant which was offered a building which suited its requirements and which was fitted out to Category B standard, would be prepared to negotiate a rent which reflected that condition and would appreciate that if it took the fitted-out building it would not have to spend its own money fitting out an alternative Category A building. That was not a situation which Mr Kempton had experienced in practice, but he recognised that "in the hypothetical world a deal would be done". Apart from that inevitable concession we are not able to place significant weight on the remainder of Mr Kempton's opinion evidence.

43. We found Mr Brankin a more straightforward witness who, perhaps uniquely for a time-served valuation officer, has real experience of being in the market; his role between 2007 and 2021 was as head of the VOA's Corporate Estate function, dealing with its many offices across the country – initially 87 locations when he took up the post. He therefore had direct experience, mostly as an occupier but occasionally where the VOA was landlord, of disposals, acquisitions, lease restructuring, lease variations, etc.

44. In Mr Brankin's view, the majority of the ratepayer's Category B fit out would have had general appeal to the market. A tenant would pay a premium for fitted out space. The amount of that premium would reflect how well the space matched the tenant's needs and what further capital expenditure would be required to complete it to their requirements. Without commenting on the precise levels of rent, Mr Brankin observed that the evidence

relied on by the VO (see paragraph 17(3) above) appeared to show a premium in the order of 15%-28% for properties fitted out to a Category B standard – the range reflecting the varying standards and ages of fit out.

Valuation evidence

45. Mr Bailey and Mr Penfold agreed a helpful schedule analysing the comparable evidence. We have some misgivings about the veracity of the information on which that schedule was based, since it was derived largely from Forms of Return submitted by ratepayers or their agents to the VOA. Mr Bailey accepted that information obtained in this way is susceptible to inaccuracy. One example of the unreliability of statements made in forms of return related to premises at Market House in Maidenhead which were described in the form of return as having been let in a shell condition, whereas the lease recorded that they were let with raised floors and suspended ceilings. In many cases, we would have preferred more complete evidence of the details of the relevant transactions from the parties or professionals involved and the parties ought to have been able to provide it (if necessary by asking the Tribunal for assistance in the form of orders for disclosure or witness summonses). However, the experts treated the information from Forms of Return as accurate when they agreed the analysis of each letting, and (except where it is contradicted by other evidence) we will do the same.

46. The experts also agreed an analysis of the September 2015 letting of Ascot House itself to arrive at effective rents assuming no rent-free period had been agreed. We will consider that analysis first, before moving on to consider the relevance and reliability of the evidence of other transactions relied on.

Analysis of the rent of the appeal property

47. Mr Bailey and Mr Penfold provided six agreed permutations. These assumed that in the absence of a rent-free period a sum equivalent to the rent foregone by the landlord during the rent-free period actually granted would be recouped by the tenant over a period either to the rent review date (five years), or to the break date (six years) or to the end of the term (11 years). In each case the value of the rent-free period was accounted for first on a straight-line basis over time, and then on a discounted basis, reflecting the time value of money concept. The six analyses ranged between £155.18 and £197.41 per sqm. Both experts preferred the discounted basis of analysis which ranged from £155.18 (where the rent-free period is recouped over the first 5 years of the term only) to £184.39 (where it is accounted for over the full 11 years). The letting in September 2015 was sufficiently close to the assumed valuation date of 1 April 2015 that the experts agreed that no further adjustment was required to account for the very nominal increase in rental values after and that the effective rental value of the appeal property in Category A condition fell within this range.

48. Some elements of the experts' agreed approach to discounting were internally inconsistent (for instance the value of car parking, which formed part of the rent, was not discounted, and their aggregated deferred rents were not then discounted to the lease start date) but as the differences these elements make are minor, and since both used the same approach when analysing the relevant comparable evidence, we do the same.

49. Both valuers referred to the RICS UK Guidance Note: 'UKGN6 Analysis of Commercial Lease Transactions' (revised April 2015) which is careful to state that 'there is no single correct approach to analysis and …. and no 'right' answer'.

50. The main point of contention was the question of the period over which the value of the rent-free period should be accounted for. Mr Bailey preferred to spread the effect over the life of the lease, as this, he said, most closely reflected the expectation of the parties to a typical office lease that their bargain would endure for the whole of the agreed term, with breaks only being instigated in exceptional circumstances. Mr Penfold, in contrast, considered there is a stronger case for analysing the rent to the earliest break date, because that reflects the certainty of rental income for the landlord, and rental commitment for the tenant.

51. Mr Penfold referred to paragraph 7.1 of section 4 of the VOA's Rating Manual, which advises: "If the transaction included a tenant's break clause, then the equivalence period cannot extend beyond that date unless the penalties, which should be reflected, suggest it is unlikely to be operated." He also relied on email correspondence with the current freehold owner of the appeal property, who confirmed that in making their purchase they calculated the equivalent yield up to the tenant's break.

52. Although neither expert made specific references to commentators other than the RICS guidance note, an instructive discussion of changing approaches to the devaluation of inducements can be found in *Bernstein and Reynolds' Handbook of Rent Review* at paragraph 9.8.7. The learned authors explain that when inducements first became recognised as a problem when analysing comparable transactions for rent review purposes, the general approach was to amortise over the period until the next rent review.

53. As more thought was given to the issue, it was appreciated that, from the point of view of the landlord, an initial concession at the start of the lease provided a stream of income (generally on an upward only review basis), secured for a period dependent upon the length of lease and the existence of tenant's options to determine, but normally longer than five years.

54. The greater recognition of the landlord's longer-term approach, coupled with the tenant's argument that the payment was a one-off, increased the use of a compromise period of devaluation, in the middle ground between the period until the next review and until the end of the lease or tenant option to break whichever is the earlier

55. Since 2008, the security of income streams has increased in importance. In many classes of property, a clear correlation has emerged between the length of tenant commitment and the level of inducements.

56. The authors conclude:

> "A consensus has emerged amongst valuers that, unless there is a specific reason not to do so, the premium should be amortised over the full term of the lease. The rationale for this is that the consideration for an incentive or premium is the grant of the lease for the whole of its term, and the rent which has been agreed is to be paid during that

> term. The rent agreed at the commencement of the term is fixed as the minimum rent payable until the end of the lease (upon the assumption that the rent is reviewable on an upwards only basis). Any premium should therefore be considered on the basis that it is a capital payment in lieu of rent for the term of the lease. Therefore, the rent should be amortised over the term of the lease.
>
> …
>
> Where there is a break clause, the rent agreed can only be guaranteed until the break clause date, the potential for the rent continuing to be paid after this date being uncertain. In such a case, even if the rent review provisions are upwards only, the initial rent is only certain until the break date. In order that the incentive should be treated on the same basis as the rent, it should only be amortised until the break date."

57. In the context of rating, analysing inducements up to a break date was preferred by the Lands Tribunal for Scotland in *Morrison EF (GP) Limited* v *Assessor for Central Scotland* [2004] RA 76. The Tribunal said that it had:

> 'no reason to doubt the reality of the tenant break options, which of course may induce new rent negotiations even if the tenant remains. It is therefore in our view correct to base calculations on the periods before the breaks and not on the full periods of the leases."

58. We acknowledge that the break clause in the subject lease did not attract a penalty, and the tenant would benefit from a further rent-free period of three months if the break clause was not exercised. However, Mr Penfold's approach appears to us to be logical and to reflect a wider consensus.

59. The result is that the letting of Ascot House, on a Category A basis, produced an agreed effective rent of £165.98 per sqm, which we will take to be £166.

Category A lettings

60. We received evidence concerning five lettings of Category A office space in or around Maidenhead, against which the letting of the appeal property may be compared. We use the parties' agreed analysis, with incentives discounted over the term of the lease in each case, unless the lease included a break clause, in which case the analysis is to the first break date. Sometimes the outcome is not entirely convincing, but that is inevitable when analysing quite complex transactions. It is important for consistency that the same approach is applied to the comparable evidence as to the letting of Ascot House itself. A proper response to imperfections in the analysis is not to abandon the comparative method of valuation but instead to rely on judgment rather than arithmetic, to avoid the temptation to place too much weight on a single transaction and to bear in mind the general patterns which emerge from the evidence as a whole.

61. The parties' agreed analysis produces the following table of Category A lettings, arranged in chronological order:

Property	Date	Lease	Adjusted Rent per sqm	Remarks
Osprey House	Jan 2013	10 yr, no break	£174	Same location as appeal property, 4,707 sqm
Sygnus Court	October 2014	10 yr, break @ 5	£165	Town centre, 2,034 sqm
1st and 2nd floors, Unit 7 Foundation Park	July 2015	10 yr, break at 5	£175	Out of town office park, 1,138 sqm
Ascot House	*Sep 2015*	*11 years, break @ 6*	*£166*	*The appeal property, 4,718 sqm*
1st floor, Unit 4 Foundation Park	June 2016	10 yr, no break	£217	Out of town office park, 454 sqm
2nd floor, Unit 4 Foundation Park	June 2016	10 yr, no break	£227	Same tenant as above, 1138 sqm

62. We doubt the reliability of the information concerning the two lettings (to the same tenant) at Unit 4 Foundation Park. Neither party was in a position to produce a copy of the relevant heads of terms or leases and the quality of the factual evidence was generally poor. It became apparent at the hearing that the tenant had received a capital contribution from the landlord of just over £52,000, for which neither valuer had accounted. It was unclear whether that contribution was paid for each letting or for both combined. There was also a suggestion that the leases were on internal repairing terms, which would therefore require adjustment to reflect the rating hypothesis. The lettings were also of much smaller units than Ascot House and we prefer to leave them out of account.

63. Mr Bailey relied upon the rents achieved for Unit 7 Foundation Park in July 2015 and Unit 4 Foundation Park in June 2016 as evidence of a growth in rental values of 13% over that period. For the reasons we have given, that analysis seems unreliable. In our view there is insufficient transactional evidence to make any specific adjustment to reflect growth in rental value, but we accept that rents were generally rising modestly over the three-year period either side of the AVD.

64. The fact that Ascot House was let at a lower rent than its immediate neighbour, Osprey House, over two years later in a rising market seems odd; but because Osprey House was let without a break clause the rent-free periods in the two transactions have been accounted for over different periods. Although this is an example of the sort of imperfection which is liable to arise when analysing complex transactions, it does not cause us to doubt our preferred approach to incentives. We do note that if the Ascot House letting is analysed over the full term of the lease, rather than to the break date, the agreed equivalent rate would be £184 per sqm, compared with £174 for Osprey House just over two and a half years earlier.

65. What we can take from the table is that there was a general tone of lettings of Category A space in Maidenhead, both in and out of town, in the order of £165 - £175 per sqm, and that the letting of the appeal property is within, albeit at the lower end of, that range.

66. There are two other lettings of Category A space of note, both in Hollywood House in Woking town centre. 1,514 sqm on the fourth and fifth floors was let for ten years from October 2013, with a tenant's break at the end of the fifth year. The rent analyses to £156 per sqm to the break clause. Secondly, 825 sqm on the third floor was let in January 2014 for a 10-year lease with a 5-year tenant's break clause, at a rent equivalent to £125 per sqm, again analysed to the break date. Those figures do not cast doubt on the rather higher tone for Maidenhead and were relied on by the VO for the existence of a differential between rents paid for Category A and Category B space. We will return briefly to Hollywood House when we consider the evidence on that issue below.

Category B lettings

67. It was common ground that open market lettings of high-quality Category B space are rare, and generally occur only when an existing tenant is seeking to dispose of space by underletting it. The valuers were forced to look further afield than Maidenhead for relevant examples, casting the evidential net across the Thames Valley. The only example they found of a substantial office building let as a whole was the Arc building in Leatherhead, to which we will return later. The other five transactions were sub-lettings of fitted suites or floors in Category B condition. The agreed analysis of the Category B comparables is below.

Property	Date	Sub-Lease	Adjusted Rent per sqm	Remarks
Future House, Egham	Dec 2012	5 yr	£233	1,731 sqm
The Arc, Leatherhead	Oct 14	2 yrs 10 months	£266	3,165 sqm
Unit 1010, Eskdale Rd, Winnersh	July 15	4 yrs 8 months	£208	2nd floor suite, 1,796 sqm, sublease contracted out of 1954 Act
1 London Road, Staines-upon-Thames	Nov 15	2 yrs 5 months	£231	1st floor suite, 569 sqm
Hollywood House, Woking	Jan 16	2 yrs 10 months	£230	4th floor suite, 783 sqm
1 London Road, Staines-upon-Thames	Mar 16	2yrs 1 month	£251	1st floor suite, 1,006 sqm

68. There appears to be a consistent rental level above £200 per sqm, and in most cases above £230 per sqm, for fitted Category B space.

69. Taken together at a very general level the open market transactions suggest that Category B space lets for higher rents than Category A space. The evidence contained no example of Category A space letting at the same or a higher rent than Category B space. But we have well in mind that all but one of the Category B transactions above involve short term lettings

of small suites in muti-occupied buildings in town centre locations. They would attract a different market, and therefore a different hypothetical tenant, from the appeal property, which is a headquarters-type standalone building with large floorplates. As Mr Bailey accepted in cross-examination, the fact that tenants of smaller suites in city centre locations would be prepared to pay a higher rent for Category B office space is not necessarily an indicator that the same is true of tenants of large headquarters-type buildings on office parks.

70. Two of the Category B lettings merit closer consideration.

71. The 2016 sub-letting of part of the fourth floor of Hollywood House in Category B condition was of part of the space referred to in paragraph 67 above, when it was let in Category A condition together with the fifth floor. At one stage it appeared it might be useful to compare the Category A rent of £156 per sqm with the subsequent Category B rent of £230 per sqm to quantify the difference in value of the respective specifications. But Mr Penfold produced evidence concerning the terms of the 2016 Category B transaction which implied that the sub-tenant had an exceptional short-term need for space; the subtenant, Birst Technology, appears to have carried out work to the premises before taking occupation, paid 50% of the sub-lease rent as a deposit, and moved out of the space in September 2017, a year before the expiry of the term – thus occupying for less than two years. These factors suggest that the transaction is not a reliable basis on which to base any conclusion about the existence or quantification of a difference in rental value between Category A and Category B space on the scale and style of Ascot House. We therefore agree with Mr Penfold that this subletting is of very limited assistance in our valuation exercise.

72. From our site inspection the Arc, Leatherhead seemed to us to be the only reasonable comparable for the appeal property in that it is a headquarters-type office building on a large office park (unimaginatively named 'The Office Park') within the green belt. Like Maidenhead Office Park, 'The Office Park' is approached by a long access road with a semi-rural feel although; being close to the M25, and closer to facilities generally, it is in a better location than Maidenhead. From our inspection we formed the impression generally that the Arc building was on the better of the two parks.

73. The Arc is a self-contained building comprising 3,165 sqm over two floors and so is only about two-thirds of the size of Ascot House. It is the more modern of the two buildings, having been built in 2001, and while Mr Bailey suggested that the Category B fit out was more dated than at Ascot House, our impression was that the Arc was a generally superior building. It was marketed in November 2008 under its previous name of Milton House. The letting particulars which we were shown described it as a "high quality headquarters office building within the Greenbelt" and included photographs of the interior, confirming that it was fully fitted out. The property was available either by assignment of the existing lease, expiring in August 2017 with rent review due in August 2011, or by way of sub-letting of the whole or part. The passing rent was not stated and unfortunately neither party was able to produce evidence of what the rent was. The Arc was underlet, in its fully fitted Category B state, for five years in October 2009. That underlease was then renewed on 16 October 2014 for a term of two years and ten months at an annual rent of £868,020, which the experts analyse to £266.67 per sqm. The sub-tenant on both occasions was KBR which the 2008 letting particulars indicate already had premises on the Park, and which we assume either expanded or relocated to the Arc.

74. The Arc provides evidence of two transactions involving a large floor-plate headquarters office building in Category B condition. Because KBR first took the property in 2009 in a fitted-out condition it can be assumed that there was no question of Category B improvements falling to be disregarded on the subsequent renewal under the 1954 Act. Although the transaction was with an existing occupier, rather than on the open market, and was in Leatherhead, the agreed rent of about £266 per sqm is the best evidence we have of the rent for a headquarters office building in Category B condition.

75. There remains the challenge of considering how the building can be compared with the appeal property when there is no evidence of rents for Category A lettings in Leatherhead. Leatherhead is a superior office location to Maidenhead, but there is only limited evidence of the extent of the difference in value. In the 2017 Rating List, the VOA places Ascot House in a valuation scheme at £215 to £270 per sqm, and The Arc in a scheme at £250 to £290 per sqm. Mr Bailey explained that the differential in the List base rate was £30 per sqm to account for location factors.

76. Mr Bailey was satisfied that the difference in value of around £30 between the Arc at £266 per sqm and his valuation of Ascot House in Category B condition At £233 per sqm was consistent with the differential base rate in the 2017 List for location, amenity etc. He accepted that no tone of the list had yet been established and that the suggested differential was largely based on his own valuation judgment.

77. He also relied on a Lambert Smith Hampton Thames Valley Market Report, which suggested prime office rents for Guildford at around £340 per sqm and Gatwick at around £265 per sqm; in his view the Arc at £266 sqm was not inconsistent with that range.

Rent Reviews and Lease Renewals

78. Mr Bailey also took account of rents agreed on lease renewals and rent reviews, but we place no weight on this material because of the absence of any contemporaneous documentary evidence or first-hand evidence from those involved in the transactions, or indeed any evidence at all about the basis on which the rents were agreed. The experts were left speculating whether an agreed rent reflected premises assumed to be in a Category A or a Category B condition. It was not even possible to determine what condition should have been assumed if the valuation had followed the correct contractual or statutory basis of valuation, because of an absence of evidence about whether work had been carried out by tenants pursuant to an obligation to their landlord or had been the subject of a capital contribution or other additional incentive.

79. In the absence of any evidence which might provide insight into the basis on which figures were agreed, we simply note that the parties referred to seven lease renewals of offices across the wider Thames Valley, from Staines to Addlestone. Analysing to lease breaks or whole terms as appropriate, the rents ranged from £191 to £284 per sqm, one of which was of Millennium House on the outskirts of Maidenhead, at £239 per sqm. The average was £240 per sqm. Similarly, in terms of the rent review evidence, we note that the ten transactions referred to, again across a wide geographic area, range from £264 to £368 per sqm, with an average of £312 per sqm. As it is impossible to know whether these rents reflect premises

in an assumed Category A or Category B condition, very little weight can be given to this material.

Assessment Evidence

80. Mr Penfold referred to a number of rating assessments which had been agreed following challenges, including one within the ground floor of Building 4 on the Maidenhead Office Park, close to Ascot House, at £175 per sqm. However, Mr Bailey had personal knowledge of all of the buildings, and we are satisfied from his evidence that in each case the hereditament relied on could not be described as Grade A accommodation.

Summary of the valuation evidence

81. Taking stock at this point, in what Mr Bailey referred to as a "basket of evidence" we have the letting of the appeal property at £166 per sqm on a Category A basis; a series of Category A lettings at £165-£175 per sqm; a series of Category B short term lettings, albeit for smaller, city centre suites, at an average of around £230 per sqm; and the letting of the Arc, Leatherhead, a headquarters office building in Category B condition but in a more valuable location, let at £266 per sqm. We also have a batch of rent reviews and lease renewals, settled on some unknown basis, at averages of £312 and £240 per sqm respectively.

82. It is notable than none of the Category A comparable evidence is as low as £165 per sqm, the agreed analysis for the appeal property's rent, which both valuers agree is a reasonable proxy for the value of the appeal property on a Category A basis. There is only one piece of Category B letting evidence, at Eskdale Road, Winnerish, which is below £230 per sqm. It is very difficult to reconcile this general picture with the respondent's case that the rateable value of the appeal property in Category B condition is £166 per sqm, or the view of the VTE that it is about £180 per sqm.

The value of the Category B fit out works

83. We have already explained why we are unable to place any weight on Mr Kempton's evidence. In any event, we prefer the evidence of Mr Brankin on the willingness of the market to pay more for Ascot House if offered for letting in Category B condition. His approach was consistent with our own expectations of how a rational market would behave and reflects the approach taken in *Dorothy Perkins* and in *Edma (Jewellers).* Even Mr Kempton eventually acknowledged that a deal would be done which would result in a higher rent for Category B space than for Category A. The fact that such transactions are very rare reflects the developer's desire to attract as wide a market as possible and does not mean that a Category B building would be unlettable or that it would command no higher a rent than in Category A condition.

84. We are also satisfied that the ratepayer's Category B fit out was, in the main, sufficiently generic and unexceptional and that it would have had what both sides referred to as general market appeal. As we have also explained, it must in any event be assumed that in its fitted-out condition the hereditament meets the needs of the hypothetical successful bidder who is

willing to take it at the market rent without requiring an allowance or inducement to reflect its condition.

The rival approaches

85. Both experts approached the valuation of Ascot House in its Category B condition by adding an amount to reflect the value of the tenant's fitting-out works to the rental value derived from the letting of the building in its original Category A condition. In principle there is nothing wrong with that approach. Faced with limited direct evidence of new comparable lettings in Category B condition it might be the only possible approach, although that is not the case here. But it gives rise to a number of issues and uncertainties. It assumes that there is a consistent relationship between the cost of fitting-out works and the enhancement of rental value over and above a Category A figure established by market evidence. But that is simply an assumption, and it is not itself confirmed or supported by market evidence. Nor, in the absence of evidence, is there agreement in principle (at least in this case) about how the capital cost of works is to be translated into an annual rental value.

86. Nevertheless, adopting the approach they considered appropriate, both valuers sought to derive an additional annual amount from the agreed fit-out cost of £1,618,274. For the ratepayer, Mr Penfold's calculation was provided as an alternative to Mr Kempton's evidence, which we have rejected, that a Category B fit-out would add nothing to a Category A rental value.

87. The parties did not agree on an appropriate method of arriving at an annual value of the tenant's fit-out work. The VO suggested that an annual equivalent should be ascertained by amortising the capital cost using a discount rate of 7%, while the ratepayer proposed that the same sum should be decapitalised using the statutory discount rate of 4.4%.

88. For the VO, Mr Bailey, when analysing to the break date (as we prefer), applied the discount rate of 7% which he had agreed with Mr Penfold as applicable to the rental streams for the appeal property. Allowing for a three-month rent-free period at the start of the lease, he divided the cost of £1,618,274 by a yp figure of 4.8039 (produced by a years' purchase formula on a quarterly in advance basis, for 5.75 years at 7%), producing an annual amount of £336,868, or £71.40 per sqm, to be added to the Category A rent to reflect the Category B fit out, resulting in £1,119,000, or £237 per sqm. In his view, this rate was consistent with the basket of evidence.

89. For the ratepayer, Mr Penfold was instructed that as a matter of law the annual value of the tenant's works should be ascertained by applying the decapitalisation rate provided by the Non-Domestic Rating (Miscellaneous Provisions) (No.2) Regulations 1989, as amended (the 1989 Regulations). The applicable decapitalisation rate for valuations in the 2017 rating list which do not involve defence, education or healthcare hereditaments is 4.4%. Mr Penfold also expressed his own opinion that the application of the statutory rate should be preferred, despite acknowledging that it was a "blunt tool"; in particular, it had the merit of simplicity and equality of application, consistent with the requirements of the rating system.

90. The statutory decapitalisation rate is simply applied to capital cost, rather than being used to arrive at a years' purchase denominator. Mr Penfold therefore applied 4.4% to the capital cost of £1,616,249 to arrive at an additional rent of £71,115, or £15.07 per sqm to reflect the category B fit out, resulting in £880,000, or around £186 per sqm.

Does the statutory decapitalisation rate apply?

91. In her written argument, Ms Wigley KC helpfully reminded the Tribunal that the statutory discount rate is a valuation tool designed for use when a hereditament is being valued by the contractor's method of valuation. The contractor's basis is an approach to the valuation of particular types of property such as schools, hospitals, and airports which share the characteristic that they are not usually the subject of a letting. For that reason, their valuation by the more conventional comparative or receipts and expenditure methods is not possible. The contractor's approach is a method of last resort which is tolerated as a means of establishing the annual letting value of property only because no better method can be found for some hereditaments.

92. The contractor's basis has most recently been examined by the Tribunal in some detail in the museum cases (*Hughes (VO) v York Museum and Gallery Trust* [2017] RA 302 at [129]-[140] and *Hughes (VO) v Exeter City Council* [2020] UKUT 0007 (LC) at [229]). It assumes that the annual rental value of a property (or at least a ceiling above which the tenant will not be prepared to go higher) can be ascertained by establishing what it would cost annually to provide the same hereditament by purchasing a bare site and constructing it (or a modern equivalent) from scratch. It involves five specific steps which, in summary, comprise (i) the estimation of the cost of construction of an alternative hereditament; (ii) an adjustment to reflect any differences between the actual hereditament and the notional alternative; (iii) the addition of the value of the land on which the hereditament stands to arrive at its effective capital value; (iv) decapitalisation of the effective capital value by the application of an appropriate decapitalisation rate; and (v) "stand back and look", a final adjustment to ensure that the valuation has taken into account all factors affecting value and that the resultant figure is a fair and proper assessment of rental value on the statutory hypothesis.

93. Before the Local Government Finance Act 1988, the decapitalisation rate used at stage 4 of a contractor's basis valuation was often the subject of complicated dispute (see, for example, *Imperial College of Science and Technology v Ebdon (VO)* [1984] RA 213, at pages 231 to 241). The 1988 Act gave the Secretary of State the power for the first time to simplify and standardise the process of assessment by prescribing a decapitalisation rate. That power has been exercised for the purpose of all subsequent rating valuation lists.

94. The 1989 Regulations prescribe standard decapitalisation rates to be adopted when ascertaining rateable value using the contractor's basis of valuation. The precise language of the relevant provisions has varied but since the 2000 list the formulation has been consistent. For the 2017 list, regulation 2(1F) provides:

> "2(1F) Paragraph (2F) of this regulation applies in relation to a hereditament shown in a non-domestic rating list compiled for a billing authority in England

> on or after 1 April 2017 the rateable value of which is being ascertained using the contractor's basis of valuation."

Paragraph (2F) of Regulation 2 then provides:

> "(2F) In applying paragraph 2(1) to (7) of Schedule 6 to the Act in circumstances where paragraph (1F) of this regulation applies, the appropriate rate is assumed to be-
>
> (a) In the case of a defence hereditament, an education hereditament or a healthcare hereditament, 2.6%; and
>
> (b) In any other case, 4.4%."

The reference in paragraph (2F) to "the appropriate rate" is explained in regulation 2(2F)(3), as follows:

> "'the appropriate rate' means the percentage rate applicable in relation to the notional cost of constructing or providing the hereditament or any part of it for the purpose of estimating the rent at which it might reasonably be expected to let from year to year;"

95. Miss Wigley KC placed some emphasis on the fact that for the 1990 and 1995 rating lists regulation 2 was stated to apply in relation to a hereditament "the rateable value of which is being ascertained by reference to the notional cost of constructing or providing it or any part of it." Unlike the current regulation 2(1F), that formulation did not refer, in terms, to a rateable value "being ascertained using the contractor's basis of valuation." It might be said that the circumstances in which the prescribed rate is intended to be used have been made clearer since the 2000 list, but we do not think the change was intended to narrow the scope for making use of it. On the other hand, there has been no change in the substance of the regulations and the original reference to "the notional cost of constructing or providing it or any part of" the hereditament has been retained in the definition of the appropriate rate. We find it difficult to attribute much weight to the reorganisation of the statutory language and we note that the same view was taken by the Lands Tribunal (George Bartlett QC, President, and Mr A J Trott FRICS) in *Allen (Valuation Officer) v English Sports Council* [2009] RA 289, at paragraph 67.

96. For the prescribed decapitalisation rate to apply, the rateable value of the hereditament must be being ascertained using the contractor's basis of valuation. The definition of "the appropriate rate" in regulation 2(2F)(3) contemplates the application of the rate to the "notional cost of constructing or providing the hereditament *or any part of it*". In their previous form the regulations similarly allowed for the application of the rate to the notional cost of constructing or providing the hereditament "or any part of it." In both *Dorothy Perkins* and in the Tribunal's more recent decision in *Berry (VO) v Iceland Foods Ltd* [2015] RA 201 the rateable value attributable to the presence of an item of plant was ascertained by applying the statutory decapitalisation rate to the capital cost of providing that item (air conditioning in the first case and air handling plant in the second).

97. Miss Wigley KC suggested that the Tribunal's approach to the valuation of the air handling plant in *Iceland* had been wrong. The Tribunal's decision was the subject of an appeal by the VO on the question whether the plant was rateable; that issue eventually reached the Supreme Court where the appeal was successful. As far as we are aware the VO did not challenge the Tribunal's valuation. More importantly, Miss Wigley KC's submission appears to us to overlook what was actually decided by the Tribunal in *Iceland* and what was agreed between the parties. The issue for the Tribunal was a legal question, namely whether it was permissible to adopt the contractor's basis of valuation where what was being valued was part only of a hereditament. The Tribunal decided that it was "permissible" (at paragraph 100). The parties agreed that if it was permissible as a matter of law to adopt a contractor's approach to the valuation of part of a hereditament, the statutory decapitalisation rate (then 5%) ought to be used (paragraph 101). None of the alternative approaches to valuation was found to be satisfactory. There was no relevant rental or settlement evidence, and the Tribunal rejected the VO's preferred method of amortising the capital cost over the lifetime of the equipment using a freehold investment yield of 7.5% (see paragraphs 105 to 108). The leaseholder's expert proposed the adoption of a flat rate said to have been based on settlements, but which bore no relationship to cost, or a decapitalisation approach at either 5% or 5.25% in each case with a wholly arbitrary 65% discount. On the basis of that evidence the Tribunal adopted the rate which the parties had agreed was appropriate if the contractor's basis could be applied to part only of the hereditament. *Iceland* should not, therefore, be taken as support for the suggestion that arriving at the annual value of a tenant's improvement by applying a decapitalisation rate to its capital cost is an application of the contractor's basis of valuation for which the statutory decapitalisation rate must be used.

98. *Dorothy Perkins* provides stronger support for the suggestion that, if the annualised cost of the ratepayer's expenditure on improvements is being used to arrive at an addition to rateable value reflecting the presence of the improvements, the use of the statutory decapitalisation rate is mandatory. The Lands Tribunal (HHJ Marder QC, President) determined, at page 415, that, in valuing an air conditioning installation:

> "… the [1989] Regulations do apply because the rateable value of part of this hereditament is being ascertained by reference to the notional cost of providing it. It follows that the appropriate rate applicable for the purpose of estimating the rent shall be assumed to be 6%."

It was not permissible, the Lands Tribunal held, to use a different rate or to amortise the capital cost over the life of the equipment. That conclusion was reached after the counsel for the VO had initially argued that the 1989 Regulations had no application in the circumstances of that case, but later conceded that they did (page 415). Whether that concession affected the outcome is not apparent, but it is noticeable that, at page 413, the Judge said that he considered it necessary to adopt "a form of contractor's test".

99. We do not accept Mr Ormondroyd's submission that the use of the statutory decapitalisation rate is, as he put it, "mandated by law" in cases of this sort. The statutory rate is applicable only "to a hereditament … the rateable value of which is being ascertained using the contractor's basis of valuation". We accept (as we did in *Iceland*) that use of the prescribed rate is not confined to valuations where the contractor's basis is being applied to the entirety

of a hereditament; it is also to be employed where only part of a hereditament is being valued by the contractor's method. But the valuation in this case is not such a valuation.

100. Before the use of the statutory rate becomes mandatory, we think it essential that the full contractor's basis, properly so described, is being employed to ascertain the rateable value of at least some part of the hereditament. It need not be employed to establish the rateable value of the whole of the hereditament, but at least in relation to part the exercise must recognisably be the ascertainment of a rateable value on the contractor's basis. We perceive there to be a difference in this respect between ascertaining the rateable value of part of a hereditament using the contractor's basis and using the annualised cost of some work of improvement of a hereditament as one component in ascertaining the rateable value of the hereditament as a whole. The former exercise involves ascertaining a rateable value, properly so called, of a subject which would be capable of having a rateable value of its own. The latter exercise does not: no separate entry is made in the rating list for a shop front, or an air-conditioning system installed in a hereditament.

101. To take an example, if a hereditament comprised an office and industrial complex for aero engineering, and some unique facility was constructed by the ratepayer in the grounds of the complex for its own purpose, for example an engine test-bed, it might be appropriate to value the offices and industrial elements by the comparative method and to value the bespoke facility using the contractor's basis. The rateable value of the hereditament would be represented by the aggregate of the two values. If the engine testing function was sub-contracted to another occupier and the hereditament was split, the test-bed hereditament would have its own entry and be valued using the contractor's basis alone. In both cases the rateable value of the hereditament (the whole) would be ascertained "using the contractor's basis of valuation" and the statutory decapitalisation rate would be required to be used.

102. That is what we understand by the reference in regulation 2(1F) of the 1989 Regulations to "a hereditament … the rateable value of which is being ascertained using the contractor's basis of valuation." We do not consider that the reference in regulation 2(2F)(3), to the appropriate rate being the rate applicable to the notional cost of "constructing or providing the hereditament or any part of it" justifies a different interpretation. We do not regard the valuation undertaken in *Dorothy Perkins* as having involved the ascertainment of the rateable value of part of the shop hereditament using the contractor's basis. It involved attributing an annual value to the air-conditioning as one step in the ascertainment of the rateable value of the shop as a whole. We do not consider that the use of the statutory decapitalisation rate is mandatory in such a case.

103. In this appeal, no part of the hereditament is being valued using the contractor's basis. The single subject of the valuation is the entirety of the appeal property. The valuers have chosen to arrive at a value for that single subject by first imagining it in Category A condition and then bolting on a sum to reflect the ratepayer's expenditure required to bring it into Category B condition. That is not an application of the contractor's basis of valuation to any part of the hereditament, and the ascertainment of the sum to be added for the ratepayer's fit-out works does not involve ascertaining the rateable value of those works or the rateable value of any part of the hereditament. A contractor's basis of valuation uses the annualised notional cost of constructing an equivalent hereditament as a measure of the value of the

hereditament to be valued. The valuers in this case have taken the actual cost of the works carried out to fit out the appeal property as the basis of their calculation of the value of the appeal property. They have undertaken a similar exercise, but not the same exercise, as a contractor's basis valuation (for example, they omit entirely the third stage of the valuation, the addition of a sum reflecting the value of the land, and the fifth, when the product of the calculation is subject to a sense check in the light of whatever other evidence is available).

104. We therefore accept Miss Wigley KC's submission that, when the 1989 Regulations refer to the contractor's basis of valuation, they mean the valuation of all or part of a hereditament using the contractor's basis in full. In arriving at an annual equivalent of the cost of the ratepayer's works as part of the exercise of valuing the appeal property as a whole, the experts are not obliged to use the statutory decapitalisation rate. Although the Lands Tribunal in *Dorothy Perkins* appears to have taken the opposite view, we are not bound by its decision and we respectfully decline to follow it.

105. Of course, the conclusion that the statutory rate is not mandatory does not mean that it cannot be used in an appropriate case. There is nothing to prevent the Tribunal or the parties from adopting that rate if it is considered appropriate to do so on the evidence. If there is no convincing evidence to help identify a more appropriate rate, the fact that the statutory rate is approved by Parliament and is required in certain valuations are both reasons why the Tribunal may be driven to adopt it rather than speculate about a rate of its own.

Valuation

106. When properly analysed, the evidence in this appeal demonstrates that Category B space, of whatever size, term of lease or location, attracts rents of more than £200 per sqm, and in many cases well in excess of that figure. Mr Penfold's valuation of £880,000, or around £186 per sqm, is therefore obviously too low. On the other hand, Mr Bailey suggests that, to avoid capital expenditure of £1.6 million, a prospective tenant would be prepared to pay £337,000 more, per year, for the appeal property fitted out to Category B standard than the ratepayer was prepared to pay for it in Category A condition. Combining that figure with the value of the building in Category A condition, plus the agreed allowance for car parking produces a valuation of £1,119,517, say £1.1 million, or around £237 per sqm. In our view, that figure is unrealistically high, equating to more than 20% of the capital cost of the fitting out work, and in simple terms over the period of this lease to the first break clause at year 6, the tenant would pay over £400,000 more than the cost of the work.

107. Putting ourselves in the position of the hypothetical parties, in the light of the required assumption that the tenant is willing to take a tenancy of the property as fitted to Category B standard, it seems more realistic to conclude that agreement would be reached on an annual rent in the region of £1 million, or £212 per sqm.

108. A Category B valuation of £212 per sqm appears to us to fit comfortably with the market evidence of Category B lettings. In particular, it is consistent with the rent of £266 per sqm agreed for the Arc, Leatherhead, which we regard as a good comparable. We accept Mr Bailey's evidence that in terms of location there is a difference of about £30 per sqm between Leatherhead and Maidenhead. Having seen both business parks, we are satisfied that The

Office Park in Leatherhead is the superior of the two and given the better quality and specification of the Arc as a building, we would expect there to be a difference of around £50 per sqm between the Arc and Ascot House. The market evidence therefore enhances our confidence that a rateable value of £212 per sqm or £1 million is fully justified.

109. We were informed before the hearing of the appeal that this appeal is regarded as a test case for the valuation of office buildings in Category B condition for the 2017 list. We have firmly rejected the proposition that a building in Category B condition is worth no more than a building in Category A condition, which should assist parties in other cases. On an appeal of such importance, we would have welcomed better market evidence demonstrating the differential between Category A and Category B space, enabling the unsatisfactory two stage approach to be avoided. Given the resources and expertise available to the parties, it ought to have been possible in this case to demonstrate that differential by evidence of the value of the Arc building when first let in Category A condition. A smaller basket containing evidence of better quality would have provided a more satisfactory test.

110. For these reasons we allow the VO's appeal and determine the rateable value of Ascot House at £1 million with effect from 1 April 2017.

Martin Rodger KC
Deputy Chamber President

Peter McCrea FRICS FCIArb
Member

25 January 2022

Right of appeal

Any party has a right of appeal to the Court of Appeal on any point of law arising from this decision. The right of appeal may be exercised only with permission. An application for permission to appeal to the Court of Appeal must be sent or delivered to the Tribunal so that it is received within 1 month after the date on which this decision is sent to the parties (unless an application for costs is made within 14 days of the decision being sent to the parties, in which case an application for permission to appeal must be made within 1 month of the date on which the Tribunal's decision on costs is sent to the parties). An application for permission to appeal must identify the decision of the Tribunal to which it relates, identify the alleged error or errors of law in the decision, and state the result the party making the application is seeking. If the Tribunal refuses permission to appeal a further application may then be made to the Court of Appeal for permission.