THE HIGH COURT

[2021] IEHC 49

[2019 No. 1436 SS]

BETWEEN

COMMISSIONER OF VALUATION

APPELLANT

V.

HIBERNIAN WIND POWER LIMITED

RESPONDENT

JUDGMENT of The Hon. Mr. Justice Alexander Owens delivered on the 26th day of January 2021.

1. This is an appeal by way of case stated by the Commissioner of Valuation (the Commissioner) arising from a decision of the Valuation Tribunal (the Tribunal) of 6 February 2018 fixing the valuation certificate for a wind farm at Grouselodge, Rathkeale in County Limerick at the revaluation date of 1 March 2012 at the net annual value (NAV) of €1,020,000. Hibernian Wind Power Limited (HWP) is the respondent. HWP is a subsidiary of the Electricity Supply Board. The property consists of six Nordex N90 2.5 megawatt turbines. I have to deal with two questions.

2. The substance of the first question asked is whether the Tribunal was correct in law in assessing the NAV of the wind farm on the footing that s.48(3) of the Valuation Act 2001 (the 2001 Act) allows a deduction of an average annual amount calculated over a 15-year period to establish a fund to enable that tenant to replace physical assets which will be worn out at the end of a 20-year period. My answer to this question is "*No*".

3. The substance of the second question asked is whether the Tribunal was correct in law in disregarding valuation evidence which extrapolated from financial accounts relating to ten wind farms in County Limerick (including the Grouselodge wind farm) and used an average price per megawatt hour and an average operational cost per megawatt hour to arrive at an average NAV per megawatt of capacity for the Grouselodge wind farm. My answer to this question is "*yes*".

4. Section 48 of the 2001 Act requires that "the value of a relevant property be determined under this Act by estimating the net annual value of the property." Subject to an exception which is not relevant to this appeal, the "net annual value" is defined in s.48(3) as:

> "…, in relation to a property, the rent for which, one year with another, the property might, in its actual state, be reasonably expected to let from year to year, on the assumption that the probable average annual cost of repairs, insurance and other expenses (if any) that would be necessary to maintain the property in that state, and all rates and other taxes in respect of the property, are borne by the tenant."

5. The Commissioner and HWP were agreed that it was appropriate to value the property using the receipts and expenditure (R&E) method. This is also referred to as the "profits" basis. At para. 16(i) of the case stated, the Tribunal summarises this method of valuation as follows:

"Under this methodology the NAV is ascertained by reference to the Appellant's accounts; working expenses are deducted from gross receipts to get the divisible balance and from the divisible balance the tenant's share (i.e. the amount required to provide a return on any tenant capital employed and a reward to the tenant for his venture reflecting the extent of the risk and the need for profit) is deducted. The remainder of the divisible balance, the landlord's share, is the amount available for the rent under the hypothetical tenancy and thus becomes the NAV."

6. It was common case that the lifetime of wind turbines is 20 years. It was also common case that it was appropriate, when using the R&E method, to make an allowance against gross receipts for the sum which the hypothetical tenant would be required to set aside, year by year, out of revenue in order to provide a sinking fund to cover replacement of the wind turbines. This annual expense is brought into account as a tenant's expense "necessary to maintain" the property in a state to command the hypothetical rent in calculating the sum available as the divisible balance.

7. When the judgments given courts dealing with this issue speak of annual payments to a "sinking fund", they mean an allowance of the "probable average annual cost" in the sense of a sum which the tenant must "annually" lay by as a reserve and invest "to make good, when it shall become necessary, an inevitable loss by the destructive agency of time…" : see Cockburn C.J. in *R (Boxford Overseers) v. Wells* (1867) L.R. 2 Q.B. 542 at 548.

8. The Tribunal agreed with the contention of HWP that the period which should be used for the purposes of calculating the annual amount which the tenant would set aside in order to meet the commitment to replace the wind turbines at the end is 15 years and not 20 years. The evidence was that electricity produced by the wind farm is subsidised under a statutory scheme known as "REFIT" which ran for a term of 15 years. This scheme provides price certainty to renewable electricity generators for each unit they provide to the national grid by subsidising the difference between the wholesale price and the "REFIT" price.

9. The effect of using the 15-year term for the accumulation of the sinking fund would be that the hypothetical tenant would accumulate a reserve fund sufficient to replace the turbines at the end of 15 years from the time when they were installed, rather than at the end of 20 years. The reserve fund could then be invested for a further 5 years until the end of the 20 years and so exceed in value the amount needed to replace the turbines. There would be no need to set aside any further annual sums into reserve between the end of year 15 and the end of year 20.

10. Both valuers used the same mathematical formula and underlying assumptions of capital cost per turbine and interest rate in calculating the sinking fund. No adjustment was made on the annual figure which the tenant would put aside to take into account that the reserve to replace the turbines after 20 years will be accumulated by the end of the 15-year period accepted by the Tribunal.

11. If the approach of the Tribunal is correct, it would follow that if the "REFIT" subsidy were to run for a period of ten years from the valuation date, the hypothetical letting envisaged by s.48(3) of the 2001 Act would assume that the tenant would use the ten year period to accumulate a sufficient reserve to replace the turbines and then hold that reserve until it was required to fund replacement of the turbines at the end of the 20 years.

12. The reasoning of the Tribunal is set out at para.10.16 of the decision:

> "The hypothetical tenant and the hypothetical landlord have every reason to expect that serious structural problems will arise in respect of the wind farm. There is therefore little reason to distinguish strongly the respective interests of the landlord and the tenant in maintaining the wind farm. Accordingly, the risk of significant expected replacement costs arising from wear and tear to the wind farm as a result of the operation of the tenants' business appears to be within reasonable bounds. In the Tribunal's opinion a sinking fund provision is a matter that would affect the minds of both the hypothetical landlord and tenant in agreeing a rent for a wind farm comprising extremely costly but wasting assets. The Tribunal considers that the prudent tenant would look to establish a sinking fund over a period of 15 years whilst revenue is guaranteed under the Refit Scheme. Looking at the position from the point of view of the landlord, a reasonable landlord would insist on the sinking fund being built up over that 15-year period so that the future capital sum required to replace the wind turbines is secured during the period when the tenant's income is guaranteed thereby avoiding any uncertainty as to the tenant's ability to make the necessary contributions to the fund thereafter."

13. Section 48(3) of the 2001 Act does not mandate that the terms of the hypothetical tenancy from year to year will include a contractual provision negotiated between the landlord and the tenant for the establishment or duration of a sinking fund. The hypothetical potential tenant is allowed to include the annual expense of establishing this reserve as an expense in calculating his bid for the yearly tenancy.

14. The NAV is fixed by reference to "the rent for which, one year with another, the property might, in its actual state, be reasonably be expected to let from year to year." The statutory assumption which must be applied is that "the probable average annual cost of repairs, insurance and other expenses (if any) that would be necessary to maintain the property in that state…., are borne by the tenant".

15. If the 15-year period is adopted, an amount will be applied annually into reserves to create a fund which will be available to fully fund renewals well in advance of the date when those renewals must be made. Unless an adjustment is made to take into account the fact that the reserve will be fully funded five years in advance of when it is needed, the payments over the 15 year period to achieve this will exceed the "probable average annual cost of ….expenses (if any) that would be necessary to maintain the property" in its actual state.

16. The wording of s.48(3) of the 2001 Act does not permit the "probable average annual cost" of an outlay which will be necessary in order to maintain the property in its current state at the end of 20 years to be calculated by reference to a 15-year period. The requirement to average out the probable costs and expenses "that would be necessary to maintain the property" and quantify them as an annual amount has a clear context. The purpose is to arrive at "the rent for which, one year with another, the property might…, be reasonably expected to let from year to year" at the valuation date on the basis of a yearly tenancy which is of indefinite duration.

17. The potential hypothetical tenant bidding to occupy the property is only concerned with the "probable average annual cost of the…expenses (if any) that would be necessary to maintain the property" in its actual state. Commercial considerations which might motivate a tenant to choose to make advance provision by setting aside annually into reserves an amount in excess of the probable average annual amount necessary to meet expenses to be borne by the hypothetical tenant under s.48(3) are not relevant. None of the authorities cited to me at the hearing support the case made by HWP on this issue.

18. The second question asked in the case stated is whether the Tribunal was correct in law in determining the NAV by reference only to the annual accounts of the actual occupier, in light of the 2001 Act as amended generally, and in particular s.48 and the hypothetical tenancy envisaged thereby and an "R&E Guidance Note" provided by the Joint Professional Institutions Rating Valuation forum.

19. The Joint Professional Institutions' Rating Forum of the Institute of Revenues Rating and Valuation has produced a detailed "Guidance Note on the R&E Method of Valuation for Non-domestic Rating". The note includes the following guidance in relation to the use of accounts:

> "In considering the accounts it is necessary to determine whether they provide a reliable basis for valuation having regard to the rating hypothesis. It is important to understand the accounting policies of the actual occupier and to know what assumptions have been made in preparing the accounts. These may not always accord with the approach of the hypothetical tenant." (5.5).
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> "The valuation is required to be carried out in relation to the relevant valuation date. The accounts available for the years preceding that date should be carefully examined to ensure that they fairly reflect the proper trading position at the valuation date." (5.6)
>
> "The number of years for which the accounts need to be considered will largely depend upon the nature of the venture. For some properties with comparatively level trading results a period of three years accounts prior to the valuation date should give sufficient information to establish a fair and reasonable indication of the trading position." (5.9)

"In the cases of new ventures where previous years' accounts do not exist, information of assistance may be found in;

(a) any business plan prepared for the new occupier (although the possibility of over-optimism should be taken into account);
(b) the accounts of similar ventures.

It may be feasible to value such properties by comparison with similar properties by using estimated receipts and expenditure based upon the accounts of similar properties. The use of hindsight, i.e. consideration of accounts for years following the AVD [antecedent valuation date], may be used as a means of confirming trends discernible at the AVD." (5.11)

20. The "Guidance Note" states the following on "Stand back and Look":

"Although not strictly a separate stage in the valuation approach, when the valuer has completed a valuation on the R&E method outlined above, it is essential to review each of the elements to ascertain whether they have been correctly applied and produce a credible result." (5.59)

"Although it is likely that comparables will not be available in sufficient numbers to enable a valuation to be prepared on the rental/comparative basis -otherwise the R&E method would probably not have been used- the valuer should consider the valuation produced against the background of valuations relating to similar properties and/or businesses. If the valuation does not appear to 'fit the pattern' so far as one is discernible, the valuer should again carry out a thorough review of the valuation adopted." (5.60)

21. The guidance note does not have any legal status. There is no rule of law which requires that any particular method of valuation must be adopted for rating.

22. The Commissioner's valuer produced an R&E valuation based on the HWP accounts for 2012 and 2013 and budget estimates for 2014 and 2015. He then went on to extrapolate figures from R&E valuations of all of the wind farms in County Limerick and produced a figure based on a standard NAV per megawatt of generating capacity of turbines of €73,000 which he adjusted to €75,212 to take into account that the Grouselodge wind farm had a capacity to generate electricity which was greater than the average capacity factor as calculated over the ten wind farms.

23. The two relevant paragraphs of the case stated read as follows:

"(vi) The second valuation…., is derived from a schedule which sets out the average figures extrapolated from the R&E valuations of all the wind farms at various locations in County Limerick and produced the valuation of €1,128,000. This scheme was devised by the Respondent because no rental data exists in the wind farm sector. The Tribunal accepted that this scheme could only have been devised after the R&E valuations were carried out in respect of both the property and the

other wind farms. In his Précis of Evidence Mr McMorrow stated that 'the R&E method is the most appropriate to arrive at a reliable estimate of Net Annual Value as it provides a lower margin of error' but nonetheless went on to 'conclude that the availability of reliable accounts for virtually all of the wind farms in Limerick provide a far more reliable evidential base and a more satisfactory methodology to assess a tenant's bid than a cost-based approach'.

(vii) It was clear that the parties agreed that the NAV of the Property should be determined by the R&E Method. The Appellant's accounts provided the more reliable approach to what the hypothetical tenant would adjudge the expenses to be than the methodology adopted by Mr. Algar [valuer for HWP] or the windfarm scheme adopted by the Respondent. The wind farm scheme is not found in evidence of rents and nor does it have the force of an established tone as it was not drawn up based on agreed valuations. Whilst the Tribunal noted that the wind farm scheme used by the Respondent to value the property was derived from virtually all of of the accounts of the wind farms in Limerick, the Tribunal could not disregard the fact that all ten wind farms in Limerick had appealed their rateable valuations to the Valuation Tribunal. The Tribunal was of the view that the valuation of the appeal Property on the R&E basis was the most appropriate method as it reflected the true trading situation of the Appellant."

24. The passages quoted by the Tribunal are from a report of the valuer for the Commissioner dated 6 August 2015 which was put in evidence. The "cost-based approach" refers to the "contractor's valuation" methodology which was abandoned by HWP at the appeal before the Tribunal. This methodology is usually used as a last resort and endeavours to value the NAV by reference to the notional costs of constructing the property. Paragraph 7.10 of the ruling of the Tribunal draws attention to the following statement in the report of the Commissioner's valuer dated 6 August 2015 which formed part of the evidence:

> "To comply with the requirements of correctness and equity and uniformity, in applying the R&E method, I have examined all available and relevant accounts and I believe that I have adopted or derived figures for revenues and operating costs that a prudent hypothetical tenant would consider reasonable."

25. The tribunal continued as follows:

> "Taking an overview of the facts pertaining to the nine other wind farms, on a 'stand back and look' approach, he adopted a €75,200 NAV per MW to yield a valuation of €1,128,000 in respect of the Property."

26. The relevant section of the report concludes with the comment:

> "My calculations for the subject property are outlined below and confidential details from other occupiers are also attached in Appendix 7 (confidential)".

27. The basis on which the valuer had access to this material was the entitlement of officers of the Commissioner to obtain information from occupiers of the other wind farms in County Limerick under s.45 of the 2001 Act and the involvement of the Commissioner in the appeals to the Tribunal in relation to the NAV fixed for all of these wind farms. It is not clear whether the individual NAVs per megawatt of generating capacity quoted for each of the individual wind farms in the valuer's report were reflected in NAVs for those properties appearing in the valuation list.

28. The methodology adopted by the valuer as shown in Appendix 1 and Appendix 2 to his report, was to arrive at an NAV per megawatt of electricity capacity using the R&E method based on the accounts and projections available and then to look at all of the accounts of the wind farms in Limerick and take averages of price obtained for electricity and operational costs per megawatt of capacity and use these averages and other assumptions to adjust the NAV for the Grouselodge wind farm from the figure thrown up by the R&E valuation.

29. The stated purpose of this exercise was "to comply with the requirements of correctness and equity and uniformity". I infer that the purpose of restricting analysis to information based on accounts relating to wind farms in County Limerick was to achieve "equity and uniformity" in the County Limerick rating list.

30. A comparative analysis by reference to receipts and expenditure of other wind farms in County Limerick would not produce any more accurate assessment of the income producing capacity of the Grouselodge wind farm than a similar analysis by reference to receipts and expenditure of wind farms in any other county. The valuer confused matters which the hypothetical potential tenant might take into account in a valuation using comparator letting values of properties in a rating list area with matters which that tenant could examine in carrying out a valuation using the R&E method.

31. The comparator valuation method allows evidence of established NAVs for similar properties in the rating list for the area. The R&E method of valuation also allows these established NAVs as part of the "stand back and look" exercise. The R&E method does not allow an averaging exercise of receipts and expenses of the sort carried out here, either by reference to accounts of wind farms in County Limerick or elsewhere.

32. The evidence of the valuer for the Commissioner on average receipts and expenses is derived from confidential information. A hypothetical potential tenant in the market would not have access to this information and would be unable to formulate a bid based on averages of receipts and expenditures of similar undertakings.

33. In the R&E valuation exercise, the potential hypothetical tenant has available the accounts or other financial information relating to the activity being undertaken on the property being valued and uses that information to calculate the divisible balance and make a bid. If that financial information is insufficient, such accounts or financial information of similar undertakings as are available can be examined.

34. The concept of "tone of the list" which is intended to ensure consistency of the NAV across a rating authority area has been explained in the judgment of Murray J. in *Stanberry Investments Limited v. Commissioner for Valuation* [2020] IECA 33 at paras. 54-75. As is clear from para. 58 of that judgment, this operates as a method of comparison and enables "valuation by reference to values as they appear in the list of properties comparable to the property in issue."

35. The exercise of looking at accounts of a similar enterprise in valuation using the R&E method is different to valuation using evidence of established NAVs of other similar properties in the relevant list of properties. In the latter method of valuation, established NAVs for similar properties are used as evidence of comparable rental values. Where the R&E method of valuation is used, the receipts and expenditure relating to the undertaking on the property are the starting point for valuation. Established NAVs relating to similar properties can be considered as part of the "stand back and look" element of the R&E exercise.

36. Examination of underlying accounts of a similar venture can only be relevant to an R&E valuation as a tool to assess whether accounts and other financial details relating to the property which is being valued are sufficiently reliable indicators of receipts and expenditure. The "Guidance Note" allows accounts of similar ventures to be examined where there is a new venture and previous years' accounts either do not exist or are insufficient to give a true and fair view of receipts and expenditure. If sufficient financial information is not available for a new venture because of absence of accounts, it may be feasible to value the property used in that venture using estimates of receipts and expenditure based on accounts of similar properties.

37. Accounts relating to the Grouselodge wind farm were available for two years and projections of income and expenditure were available for a further two years. The R&E valuation was derived from this information. There was no suggestion that the accounts and projections were insufficient to give a true and fair view of likely receipts and expenditure of the property if it was let at the valuation date. It was not thought necessary to look at the accounts of any comparable wind farm in order to verify receipts and expenditures or make an adjustment in the computation.

38. Instead, the Commissioner's valuer calculated averages of prices of electricity per megawatt hour and operational costs per megawatt hour which he derived from the accounts relating to ten wind farms. These figures were used to calculate the NAV for each megawatt of capacity of the Grouselodge wind farm in substitution for the R&E valuation figures.

39. There may be many potential variables within activity reflected in receipts and expenses extrapolated from accounts of a number of wind farms. The business model may be different in each operation. Operators may have employees or may use contractors. The wind farm may supply electricity or be charged within a group structure managed by a holding company. An operation may benefit from economies of scale or location. It would

be impossible to get any degree of assurance from an averaging exercise that like is being compared with like, even where an attempt is made to adjust for these variables.

40. The purpose of valuation is to value a specific property and not some imaginary property which might have notional average levels of annual receipts and expenses. The evidence of the valuer for the Commissioner pointed to nothing which would justify the Tribunal in disregarding the actual accounts and records of receipts and expenditure for the Grouselodge wind farm.

41. Where the NAV of a similar property is established in the rating list, this can be considered as part of a "stand back and look" exercise in conducting an R&E valuation, on the principle set out in para 5.60 of the "Guidance Notes". The need to fully review the R&E computation and perhaps make an adjustment only arises if the valuation does not appear to "…'fit the pattern' so far as one is discernible". The weight or value which may be attached to this evidence derived from the "tone of the list" will depend on the extent to which NAVs of similar properties appearing in the list have been accepted or confirmed on appeal.

42. Any suggested NAVs per megawatt of electricity capacity quoted for wind farms in County Limerick derived from accounts relating to those properties were not established as a reliable benchmark because all of the valuations for these properties were under appeal to the Tribunal. The appeals related to properties valued by the R&E method. It was likely that issues would arise in the appeals touching on receipts and expenses used to arrive at a divisible balance. The Tribunal was entitled to take this into account.

43. If the basis of valuation was comparison with letting values of other comparable properties, the accounts of businesses carried on in those properties would not be relevant. This rule applies where NAVs of properties in the rating list are established as a benchmark and are thus available for the purposes of the "stand back and look" exercise in an R&E valuation.

44. If accounts relating to properties having an established NAV are not relevant to valuation for rating purposes of other similar properties, it is difficult to see that averages of receipts and expenditure taken from accounts relating to properties which do not have an established NAV should have any evidential status in rating similar properties either.

45. The exception to the rule which allows examination of accounts of similar undertakings to be considered in an R&E valuation, is confined to cases where the accounts and other financial records of the property being valued are not sufficiently reliable to enable the hypothetical potential tenant to form a view on the likely receipts and expenditure. This may be because the records do not cover business activity for a sufficiently long period or because of some other factor which points to their unreliability. Accounts and records of receipts and expenditure of a comparable undertaking then become relevant. Such records may be used to establish the likely receipts and expenditure or to verify or vary a conclusion which would otherwise be drawn from inadequate financial information.

46. Where such comparator accounts are available, it may be necessary to make adjustments. Just as the accounts relating to the property being valued may show receipts and expenditure at odds with the potential of the property to generate receipts at the valuation date or expenses in excess of those which might be expected, the accounts of a comparator undertaking may reflect special features peculiar to the business of that undertaking which are irrelevant to the undertaking being valued.

47. The Tribunal was entitled to disregard the averaging exercise for receipts and expenses. While it is correct that the hypothetical intended tenant is concerned with the income earning potential of the property, which may be greater than that shown in the operator's accounts, the starting point is always the actual accounts and other records of receipts and expenditure.

48. The evidence derived from the extrapolation was not admissible for the "equity and uniformity" purpose for which it was tendered. It was not relevant to any valuation matter referred to in the "Guidance Note". It was of such a general nature that it could not be used in a "stand back and look" approach to assess the "correctness" of the divisible balance element in the of the R&E valuation exercise. It was introduced as a substitute for analysis of the accounts and financial information concerning receipts and expenditure of the wind farm. It was not available to the potential market of hypothetical tenants.

49. The Tribunal acted correctly in rejecting this evidence. The Commissioner has not identified any legal error in the reasoning which led the Tribunal to reject evidence based on the extrapolation by the valuer of material from the accounts relating to the ten wind farms.