UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2014] UKUT 0146 (LC)
UTLC Case Number: RA/40/2013

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – valuation - car showroom and workshop in need of repair - whether a reasonable landlord would consider the works of necessary repair to be uneconomic - whether works carried out were repairs or improvements - held majority of works were repairs – evidence insufficient to determine whether uneconomic - Local Government Finance Act 1988, Schedule 6, para 2(1)(b)

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE VALUATION TRIBUNAL FOR WALES

BETWEEN **THOMAS & DAVIES (MERTHYR TYDFIL) LTD** **Appellant**

and

SUSAN JENNIFER DENLY **Respondent**
(Valuation Officer)

Re: Car Showroom and premises
Pentrebach Road
Merthyr Tydfil
CF18 1YA

Before: N J Rose FRICS

Sitting at Merthyr Tydfil Combined Court Centre, The Law Courts, Glebeland Place, Merthyr Tydfil, Mid Glamorgan, CF47 8BH
on
25 March 2014

Mr Neil Bevan, company accountant, for the Appellant
Mona Bayoumi, instructed by HMRS solicitor for the Respondent

The following cases are referred to in this decision:

Lurcott v Wakeley (1911) 1KB 905
Conn v Robins Brothers Ltd [1966]
Saunders v Maltby (VO) 1977 RA 109
Archer Ltd v Robinson (VO) 2003 RA1 (LT)
16/18 Princess Street (Ipswich) Ltd v Bond (VO) 2002 RA 212 (VT)
Anstruther - Gough - Calthorpe v McOscar [1924] 1 KB 716
Morcom v Campbell-Johnson [1956] 1QB 106
McDougall v Easington District Council [1989] EG11

DECISION

Introduction

1. This is an appeal by the ratepayer, Thomas & Davies (Merthyr Tydfil) Ltd, against a decision of the Valuation Tribunal for Wales, South Wales Region (the VTW), reducing the assessment in the 2010 rating list of a car showroom and premises at Pentrebach Road, Merthyr Tydfil (the appeal property) from RV £79,000 to RV £78,500. The latter figure was put forward at the hearing by the then valuation officer, Mr P Heath, and accepted by the VTW.

2. The appellant agrees that an RV of £78,500 would be appropriate if the appeal hereditament had been in reasonable repair on the material day, 1 April 2010. Its case is that it was not in reasonable repair, that a reasonable landlord would have considered it uneconomic to carry out the necessary repairs, and that consequently the assessment should be further reduced by 50 per cent.

3. Before me the VO, Ms Susan Denly MRICS, contended that a reasonable landlord would have considered it economic to carry out such repairs as were necessary, and the appeal hereditament should therefore be valued on the assumption that it was in reasonable repair.

4. The appeal was conducted in accordance with the Tribunal's simplified procedure. Mr Neil Bevan, company accountant, appeared for the appellant and gave evidence. Ms Mona Bayoumi of counsel appeared for the VO, and called Ms Denly to give expert evidence. Following the hearing I inspected the appeal property internally and externally. I also made external inspections of three neighbouring car showrooms which had been cited as comparables. During the inspections I was accompanied by the two witnesses and Ms C Thomas, the appellant's company secretary.

Facts

5. In the light of a statement of agreed facts and the evidence, I find the following facts. The appeal property is located approximately two miles from the A470 by-pass and four miles from the A4065 Heads of the Valleys Road. It is one of four main dealer car showrooms in this location. On the material day the appellant operated two car dealerships from the appeal property, namely Citroen and SsangYong.

6. At the material day the appeal property (which includes a workshop adjoining the showroom) was of traditional construction dating from the 1960s, with concrete screed floors and corrugated asbestos clad walls and roof with a metal frame and half height brickwork to walls. The workshop had a dual pitch roof and the first floor office/stores sections had a flat felt roof. The accommodation (measured to gross internal area) was arranged as follows:

Ground floor	m^2

Showroom	621.9
Workshop/staffroom/wcs	877.5
Workshop/store	69.4
Valeting bay	54.3
First floor	
Offices	58.7
Internal store	147.3
	1,829.1 m^2

In addition there were 38 vehicle display and parking spaces fronting Pentrebach Road and 26 general parking spaces for staff and customers at the rear of the workshop. The appellant occupied the property under a lease for 99 years expiring in 2063, at a current ground rent of £850 per annum.

7. On 27 March 2012 the appellant applied for detailed planning permission for "re-cladding of building, removal of existing canopy and other minor alterations to external elevations including windows and doors." Permission was granted on 9 May 2012 with no conditions. The permitted work were carried out between October 2012 and March 2013, following which the SsanYong franchise was given up.

The statutory provisions

8. Sub-paragraph 2(1) of Schedule 6 of the Local Government Finance Act 1988 , as amended by section 1(2) of the Rating (Valuation) Act 1999 (referred to hereafter as sub-paragraph 2(1)) provides as follows:

> "The rateable value of a non-domestic hereditament none of which consists of domestic property and none of which is exempt from local non-domestic rating shall be taken to be an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year on these three assumptions –
>
> (a) the first assumption is that the tenancy begins on the day by reference to which the determination is to be made;
>
> (b) the second assumption is that immediately before the tenancy begins the hereditament is in a state of reasonable repair, but excluding from this assumption any repairs which a reasonable landlord would consider uneconomic;
>
> (c) the third assumption is that the tenant undertakes to pay all usual tenant's rates and taxes and to bear the cost of the repairs and insurance and the other expenses (if any)

necessary to maintain the hereditament in a state to command the rent mentioned above."

Mr Bevan's evidence

9. Mr Bevan said that, in 2007, the appeal property was in need of substantial repair and refurbishment. Certain areas were unuseable, there was asbestos in the walls and roof, some ceilings had collapsed, some wcs were unuseable, the roof was leaking, there were gaps between windows and walls, the electrical system was unstable, and the external perimeter parking areas were rutted and potholed. The Trust which owned the freehold interest was not prepared to incur the expenditure needed to repair the property.

10. Mr Bevan said that, in 2007, the appellant obtained an estimate from a contractor called Kelray to carry out repair works to the appeal property in the sum of £319,075.67 excluding VAT. At the time it was not realised that asbestos removal would be required. Nor was provision made for the cost of re-tarmacing the perimeter of the site. The cost estimate in excess of £250,000, referred to in the appellant's originating proposal, was derived from the Kelray estimate, the appellant having been persuaded that it could avoid carrying out certain works which had been included in that quotation. It subsequently became apparent that such works were in fact essential, and that in addition asbestos in the walls and roof had to be removed and the car parking areas re-surfaced; that additional internal works were required; that the extent of necessary electrical works was greater than originally envisaged; and that substantial professional fees would be incurred in connection with the works. In the event the total cost of the work carried out by the appellant was £503,365 plus VAT.

11. From 2006 onwards the appellant attempted to raise the finance required to carry out the necessary works. It could not convince potential lenders that such works were economic, since the expenditure required would have eliminated the retained earnings and net worth of the business. In 2011 finance of £400,000 was eventually offered. This was, however, insufficient to carry out all the required works. The building project was therefore delayed until October 2012, when it became essential if the appellant's Citroen franchise was not to be withdrawn. In order to secure the necessary moneys the director of the appellant company had to provide personal guarantees. This was essential if the company was to continue in business, with the possibility that it could continue to occupy the appeal property until the end of the lease in 2063.

12. The eventual cost was approximately double the estimate which had been received from Kelray Ltd in 2007. Mr Bevan explained that the appellant's understanding of the extent of the necessary works increased greatly between 2007 and 2012. In particular it became apparent that it would be necessary to remove asbestos, re-clad the walls, re-tarmac the perimeter parking area significantly increase electrical works, disconnect and then re-fit workshop plant and replace radiators and a dwarf wall. Substantial professional fees were also incurred, and none of these additional items had been taken into account in the 2007 estimate.

13. Mr Bevan said that, although the premises had a more attractive appearance after the works had been completed, the appeal property was essentially the same, albeit repaired and renewed with

modern materials. The character of the premises had not changed. The extent of the works required was such that the appeal property should not be deemed to have been in a state of reasonable repair for rating purposes on the material day.

14. Mr Bevan produced documentation which, he said, demonstrated that the works had all been included in the company's approved accounts as revenue expenditure on repairs, as opposed to capital expenditure on improvements. The accounts had been submitted to HMRC and no queries had been raised. He also supplied documentation that the appellant had received from Citroen, setting out its re-branding directives regarding signage, furniture and apparatus. The property upgrade required by Citroen was limited to the colour of the external cladding that could accommodate Citroen's external signage, and the internal walls and ceiling that could accommodate their furniture and marketing apparatus.

15. Mr Bevan summarised the appellant's expenditure on the appeal property as follows:

	£	£
Legal, planning and professional fees	35,492	35,492
Main building contract		
Preliminaries	8,000	
External works	59,295	
Asbestos removal	32,345	
Roof and wall cladding	180,085	
Internal works	107,752	
Utility renewals	7,358	
	394,835	394,835
Electrical contract	40,881	
Equipment and fittings renewal	12,112	
Reinstatement of workshop plant, etc	20,045	
	73,038	73,038
		£503,365

16. He said that the appellant had had to rent additional land on the opposite side of Pentrebach Road to accommodate the new vehicle stock that was essential to its car franchise. That land was assessed separately at RV £34,250.

17. Mr Bevan produced a calculation based on the assumption that the works of repair to the appeal property could have been carried out for the sum of £250,000 – that is the estimated figure in 2007; that at 1 April 2008 (the antecedent valuation date) a 10 year loan might have been available at 10% interest to fund that expenditure, plus an annual capital repayment of £25,000. The rent payable for the appeal property plus the additional car display site (based on the RVs in the 2010 list) plus interest and amortisation payments would total £163,250 per annum. By comparison the rents payable for the three other car franchise premises in the vicinity, based on the 2010 RVs, would be £53,000 for Capital Motors (with a similar site area); £42,500 for Southern (Merthyr) (also with a similar site area); and £98,000 for Evans Halshaw (with twice the site area of the appeal property).

18. Mr Bevan concluded that the rents implied by the RVs of the two properties occupied by the appellant showed that the expenditure required was not a viable economic proposition for that company as at 1 April 2008. The RV of the appeal property should accordingly be reduced by 50 per cent until it was in a comparable condition to the other properties occupied by its competitors.

19. In answer to questions from me Mr Bevan said the original, unlined corrugated asbestos pitched roof was replaced with insulated, plastic coated metal sheeting; the upper sections of the external walls, which were previously clad with corrugated asbestos above half height brick or blocks, were similarly re-clad; the suspended ceilings with inset lights in the ground floor showroom areas and three first floor offices were replaced with modern equivalents; 17 radiators on the ground floor were replaced with modern equivalents; two new electric boxes were provided to replace the previous dated systems; the internal walls in the showrooms, half of which had previously been drylined, were all drylined to present a consistent appearance; all external parking areas were resurfaced; all external windows were replaced with modern, double-glazed units; and one set of male and female wcs, and one disabled wc, all on the ground floor, were renewed. No works were carried out to the floors or (with the exception of 17 radiators), to the heating system.

Ms Denly's evidence

20. Ms Denly produced a breakdown of the valuation of RV £78,500 which had been accepted by the VTW and subsequently agreed by the appellant as the value of the appeal property in reasonable repair. The valuation was based on a rate of £60 per m^2 for the ground floor showroom and first floor offices, with the remaining space taken at lower rates. Ms Denly expressed the view that the tone basis of £60 per m^2 was consistent with that which had been applied to the neighbouring showrooms, having regard to age, character and location. She considered that the most similar building was that occupied by Evans Halshaw, who operated a Ford dealership. Like the appeal property before the building works were carried out in 2012/13, this comparable was constructed in the 1960s. It comprised a car showroom and ancillary workshops under a dual span corrugated asbestos roof with a two-storey showroom and office building under a pitched roof. The 2010 RV of £98,000 had been agreed with Rapleys, based on the same showroom rate (£60 per m^2) and the same

front vehicle display and customer/staff parking rates (£200 and £50 per span) respectively as had been applied to the appeal property.

21. The second comparable was a Vauxhall dealership operated by Southern (Merthyr) Ltd. The showroom was built in 1974. The 2010 RV had been appealed and subsequently accepted after discussions. It was based on a tone price of £60 per m^2 with a 10% allowance for access via the adjoining premises. Again, the front vehicle display and the customer/staff parking spaces had been taken at £200 and £50 respectively.

22. The third comparable, the VW dealership known as Capital Motors, was a modern car showroom built in 1998. The 2010 list RV of £53,000, based on a tone price of £70 per m^2, had not been appealed. The vehicle display spaces had been valued at £200 per m^2 and staff and customer parking at £1.50 per m^2.

23. Ms Denly said that she had first inspected the appeal property in October 2013, by which time all the work in question had been completed. Her understanding of the condition of the property at the material day had been based on material supplied by Mr Bevan, including two photographs dated August 2009.

24. In her opinion the property which she inspected in 2013 was of a completely different character from that which had existed on the material day. In 2010 the external appearance had been of a run-down former petrol filling station and workshops. There had been a canopy covering the forecourt. At the front of the property vehicles were displayed on rutted tarmac. The building works had transformed the property. The canopy was removed, the whole of the exterior was re-clad and upgraded, with insulation and new windows provided. The works which Citroen had insisted upon as a condition of continuing the appellant's franchise, including the re-branding on the front elevation and the internal works to the showroom, were works of improvement.

25. When assessing the costs of the works which were necessary at the material day to bring the appeal property to a state of reasonable repair, Ms Denly considered it necessary to distinguish between works of repair and works of improvement. Since the appellant had not provided a detailed breakdown of the costs it had incurred, it had been necessary to seek the opinion of a building surveyor on the cost of those items which appeared to be repairs. A report had been obtained from Mr Richard Bryan MRICS. Mr Bryan's assessment of the property's "pre-works" condition was based on an asbestos survey report which the appellant had commissioned from MSS Environmental in 2012 and historical photographs and invoices produced by Mr Bevan. Mr Bryan concluded that the cost of the repairs necessary on the material day, based on prices at the antecedent valuation date (1 April 2008) was £240,000.

26. Ms Denly observed that, given the agreed RV of £78,500, an expenditure of £240,000 in order to put the appeal property in repair represented approximately 3 years rent. In her view the hypothetical landlord would have considered such expenditure to be economic. Accordingly, no deduction in RV to reflect the state of disrepair of the appeal property was justified.

Legal submissions

27. In essence Mr Bevan's case was that the works carried out by the appellant were all repairs, not improvements, and that it would not have been economic for a tenant to carry them out without a significant reduction in rent. The first step was to determine whether or not the entirety of the property was being renewed or replaced. He said that the doctrine of the entirety was summarised by Buckley LJ in *Lurcott v Wakeley* [1911] 1 KB 905 in these terms:

> "Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole, but substantially the whole subject matter under discussion ... it follows that the question of repair is in every case one of degree, and the test is whether the act to be done is one which in substance is the renewal or replacement of defective parts or the renewal or replacement of substantially the whole."

28. Mr Bevan said that the entirety would normally be the whole property that was let. If a damaged roof was replaced HMRC would accept the cost as allowable revenue expenditure. Even if repairs were substantial they were not improvements for tax purposes, provided the character of the asset remained unchanged. For example, if a property was refurbished the type of repair work carried out might include stripping out old items, installing replacement items, repairs to structure and associated re-plastering and re-wiring.

29. In *Conn v Robins Brothers Ltd* [1966] it was held that what was regarded as repair would change with the passage of time to reflect improvements in technology. As a result HMRC now accepted that the replacement of part of the entirety with the nearest modern equivalent was allowable as a repair for tax purposes and not disallowable as improvement expenditure.

30. As a result of improved building standards, HMRC now considered that replacing single glazed windows with their double-glazed equivalent was allowable repairs expenditure. As a general rule, if the replacement of part of the entirety was either like for like or with the nearest modern equivalent, the expenditure was accepted by HMRC as being on repairs.

31. Ms Bayoumi submitted that the second assumption in sub-paragraph 2(1) should be applied in this particular context of the building being valued. What was reasonable repair would vary according to the age and type of the property, the mode or category of occupation, the locality in which it was situated and all the surrounding circumstances (see *16/18 Princess Street (Ipswich) Ltd v Bond (VO)* 2002 RA 212 (VT) at page 239).

32. Ms Bayoumi said that guidance as to what was meant by the term was to be found in both rating and landlord and tenant case law. Whether the works were repairs for corporation tax purposes was not relevant. The leading authority was the landlord and tenant case of *Anstruther – Gough - Calthorpe v McOscar* [1924] 1 KB 716. From that case it could be taken that "reasonable repair" in relation to a property was such condition as a property might have been expected to be found in had it been managed by a reasonably minded owner having full regard to the age of the

building, the locality, the class of tenant likely to occupy it and maintained in such a way that only an average amount of annual repairs would be necessary in the future.

33. That provision as to the assumed state of reasonable repair was subject to an exception as a result of the enactment of sub-paragraph 2(1) which gave statutory expression to existing case law. In *Saunders v Maltby* [1976] RA 109 it was established by the Court of Appeal that whether the state of disrepair of premises was to be taken into account in estimating rateable value depended on whether, on economical grounds, a reasonable landlord could be expected to remedy any existing disrepair. If the expenditure required to effect repairs was so great that it did not make economic sense to do so, the RV would be estimated on the basis that the landlord would not do all the repairs, but would instead accept a lower rent for the premises consistent with a reduced repairing obligation. This case was also authority for the proposition that the financial resources of the ratepayer were irrelevant, since the repairing liability rested on a hypothetical landlord, and not an actual one.

34. The statutory assumption only required that the hypothetical landlord would repair the property assuming it was economically reasonable, not that the landlord would improve the premises (see *Archer Ltd v Robinson (VO)* RA/19/2002 (LT) at paras 59 and 60). Nor was it relevant to consider whether or not the tenant would pay the cost of the repairs.

35. It was therefore essential to establish the difference between what could be considered repairs, and what could be considered improvements. In the Court of Appeal judgment in *Morcom v Campbell-Johnson* [1956] 1 QB 106 at page 115, Lord Denning said:

> "It seems to me that the test, so far as one can give any test in these matters, is this: if the work done is the provision of something new for the benefit of the occupier, that is, properly speaking, an improvement; but if it is only the replacement of something already there, which has become dilapidated or worn out, then, albeit that it is a replacement by its modern equivalent, it comes within the category of repairs."

36. In the more recent Court of Appeal decision in *McDougall v Easington District Council* [1989] EG11 Mustill LJ examined various authorities on the subject of repair. In a landlord and tenant contest he discussed three tests, which may be applied separately or concurrently as the circumstance of the individual case may demand, but were all to be approached in the light of the nature and age of the premises. The tests were:

(i) whether the alterations went to the whole or substantially the whole of the structure or only a subsidiary part;

(ii) whether the effect of the alterations was to produce a building of a wholly different character from that which had been let;

(iii) what was the cost of the works in relation to the previous value of the building and what was the effect on the value and life span of the building.

37. Ms Bayoumi submitted that the burden was on the appellant to make out its case. The appellant had failed to provide any or any adequate evidence to rebut the estimated building cost referred to by Ms Denly, or her conclusions.

38. Notwithstanding the above, it was the VO's case that the repairing assumption did apply to the appeal property, and that the cost of the repairs was economical. More than half of the expenditure incurred by the appellant was properly classifiable as improvement, or works essential to commercial branding as a Citroen dealership and should not be considered to be repairs for the purposes of sub-paragraph 2(1). Indeed, the interim fee invoice submitted to the appellant by its architects, Allan Stuckey, on 12 October 2012, described the works as "Proposed new cladding to elevation and internal improvements."

39. Ms Bayoumi pointed out that the cost of repairs as estimated by Mr Bryan was very close to the estimate of £250,000 given by the appellant in its originating proposal dated 3 September 2010 ("The property is in need of significant repair/renovation to enable it to be used as a car sales showroom and the roof needs to be replaced. The expenditure required exceeds £250,000"). The appellant used the same figure in its statement of case, when seeking to demonstrate that expenditure of that magnitude was not economically viable.

40. Ms Bayoumi submitted that Ms Denly's approach was in line with the principles set out in *Archer* and *16/18 Princess Street*, In the latter case it was held that any reasonable landlord would look at the market, consider the location of the premises, the likelihood of finding a tenant for the actual property, the likely length of any lease, whether further tenants were likely and from these answers determine over how long he would be prepared to spread the costs. In that case, on the basis that the repair costs could be spread over 5 years, they could not be said to be uneconomic. In the case of the appeal property, on the basis of the agreed RV of £78,500, the estimated cost of repairs of £240,000 reflected approximately 3 years rent to a hypothetical landlord. Such works were clearly reasonably economical.

41. Further, Ms Bayoumi submitted that even if the entirety of the works were considered works of repair rather than improvements, it was clear that the work was economical since the appellant did in fact carry them out between November 2012 and March 2013. In addition, the appeal property was occupied by the appellant as a car showroom on the material day, which showed that, whilst it may have been in a poor state of repair, it was not so bad as to prevent its use and occupation.

42. Ms Bayoumi also submitted that the fact that the appellant occupied an additional car parking area on the opposite site of Pentrebach Road was not relevant to the valuation of the appeal hereditament. The latter should be valued on the assumption that it was vacant and to let on the open market, irrespective of its value to the particular occupier for the time being. Ms Denly had explained how the RV had been calculated by comparison with the three comparables; and the figure of £78,500 had now been agreed by the appellant. The fundamental point, which had been accepted by the VTW, was that the appeal property in its existing state was in use by the appellant at the material day as a car showroom. The fact that works were required to enable the appellant to maintain its Citroen franchise demonstrated such works were improvements.

Discussion

43. As this appeal has been argued, the principal issue is whether the works which were carried out to the appeal property in 2012 and 2013 were all in the nature of repairs, as contended by the appellant, or whether the VO is right to suggest that they included an element of improvement.

44. In determining this issue, the Tribunal is bound to follow previous judgments of the Court of Appeal. In my view the most pertinent judgments are those of Lord Denning in *Morcom* and Mustill LJ in *McDougall*.

45. In *Morcom* it was held that the test was whether the work was the provision of something new for the benefit of the occupier, or whether it was the replacement of something which was dilapidated or worn out, albeit by its modern equivalent. The appellant pointed to the fact that HMRC had accepted that, for corporation tax purposes, all the works carried out were in the nature of repairs. The VO suggested that the decision of HMRC was irrelevant. In my judgment, whilst HMRC's decision is not determinative of this appeal, it is relevant background material to be borne in mind when considering all the evidence before me. The VO suggested that different principles applied for rating and tax purposes when distinguishing between repair and improvement. No authority was produced in support of that suggestion and as at present advised I am not persuaded that it is well-founded.

46. The VO considered that the works were driven by Citroen's requirements, and that they resulted in a complete change in the character of the appeal property. Mr Bevan accepted that the decision to go ahead with the work in 2012 was triggered by Citroen's insistence that the colour of the external cladding be appropriate for their signage, and that the internal walls and ceilings should be suitable for their furniture and marketing equipment.

47. Mr Bevan was a straightforward witness. I accept his evidence on the limitations of Citroen's requirements. I also accept his evidence that the roof and wall cladding had to be replaced because the former was leaking badly, and because both contained asbestos which required removal; and that the new cladding material was the modern equivalent of the original.

48. There is no doubt that the effect of renewing the cladding was greatly to improve the external appearance of the appeal property; it now looks like a modern showroom instead of a converted former petrol filling station. That, however, is merely an incidental benefit to the appellant of the fact that the property was in disrepair and is now clad with the modern equivalent of the original 60 year old material.

49. In the light of the evidence and my inspection, I find that the only element of the relevant works which was not the replacement of something which was dilapidated or worn out consisted of the suspended ceilings and integral lighting, together with the internal partitioning in the ground floor showroom area. These works were carried out to meet Citroen's requirements, and there was no

evidence to suggest that the showroom walls and ceilings were previously in disrepair. Otherwise, based on the *Morcom* test, the remaining works were all repairs.

50. I now consider the works in the light of the three *McDougall* tests, which must be approached in the light of the fact that the appeal property is over 50 years old, and has undergone various physical and user changes in that period, having originally been designed as two workshops. The *McDougall* tests and my conclusions on them, are as follows:

(i) Did the alterations go to the whole or substantially the whole of the structure or only a subsidiary part? No works were carried out to the ground floor workshop and stores and valeting bay (1,001m^2) or the first floor store (147 m^2), except to the extent that those areas benefited from the replacement of cladding and electrical wiring. Since that accommodation accounts for more than 60 per cent of the gross internal area of the appeal property, I do not consider that the alteration went to the whole or substantially the whole of the structure.

(ii) Was the effect of the alterations to produce a building of a wholly different character from that which had been let? The character of the workshop, valeting bay and store was not materially altered. Since they comprised the majority of the space in the building, the character of the latter was not wholly different after the works had been completed.

(iii) What was the cost of the works in relation to the previous value of the building and what was their effect on the value and life span of the building? The appellant's leasehold interest was valued for bank purposes in 2009 at £650,000. The cost of the works, £503,000, was equivalent to 77.4% of that value. That figure included works to the showroom which I have found were works of improvement. There was no evidence as to the value of the leasehold interest after the works had been completed. The life of the property following the works was likely to last for at least 60 years. In Mr Bryan's view – which I accept – the only factor limiting the building's life span before the works were carried out was the fact that the roof was leaking.

51. In my judgment, notwithstanding the element of improvement, the relationship between the cost of the works and the previous leasehold value points towards improvement rather than repairs. All the other tests point in the opposite direction or are neutral. I do not think that an analysis based on the *McDougall* tests, considered together, points to a different conclusion from one based on the *Morcom* approach.

52. I would add that the fact that the appellant did in fact carry out the disputed works is not relevant to the question to be decided under sub-paragraph 2(1). Mr Bevan said – and I accept – that the appellant's decision to proceed with the works was taken so that it could continue its business in the long term. The decision to carry out works, taken by the occupier of a hereditament who has occupied the premises under a long lease at a ground rent for many years and wishes to continue

doing so, is of no assistance when deciding whether a hypothetical landlord of a property which is vacant and to let would have considered that such works were uneconomic.

53. For substantially the same reason, the fact that the appellant's landlord, who was receiving a ground rent from the property, was not interested in funding the necessary works, is of no relevance to the issue in this appeal.

54. Nor do I consider that the calculation put forward by Mr Bevan in support of his appeal – namely adding the RVs of the premises occupied by the appellant to the amortised cost of the necessary repairs – is of material assistance. That is because there is no reason to assume that the hypothetical landlord of the appeal property for rating purposes would necessarily be responsible for a substantial (or any) rental payment in addition to the cost of the works.

55. Having reached the above conclusions, I find that the evidence before me is insufficient to enable me to decide what was the cost – as at the antecedent valuation date – of the items which I have found to constitute repairs (see para 49 above), nor whether a hypothetical landlord would have considered that such costs were economically viable. Accordingly, the parties are invited to seek to reach agreement on these issues within 21 days of the date of the letter accompanying this decision and to inform the Tribunal of such agreement, following which the appropriate order will be made. In the absence of agreement, the parties must submit written representations in support of their respective cases within a further 14 days. Such representations must be copied simultaneously to the other side and counter-representations, if any, submitted to the Tribunal and the other side within a further 7 days.

Postscript

56. That I have not yet been able to reach a final conclusion on this appeal results from the fact that no detailed breakdown of the cost of the works was provided by the appellant and no formal analysis and costing of the wants of repair of the building was provided by the VO. In a letter to the Lands Chamber dated 4 March 2014 – only three weeks before the hearing – the VO's solicitor asked for permission to serve and file two expert reports, the second being from a building surveyor containing an estimate of the cost of repairs which he considered were necessary at the appeal property. The appellant objected to this application. I refused permission to call a second expert because, in the respondent's notice dated 17 September 2013, the VO had indicated that she was unsure whether she wished to call more than one expert witness; on 5 December 2013 the VO agreed to the appeal being conducted under the simplified procedure, such hearings being almost invariably completed in one day; and the application for the second witness was made at an extremely late stage, with no reason given for the delay.

57. I would emphasise the need for parties to Lands Chamber appeals to decide as soon as reasonably possible whether expert evidence from more than one witness is necessary and, if so, to make formal application for the necessary permission without delay.

Dated: 4 April 2014

N J Rose FRICS

Addendum

58. Following publication of my interim decision dated 4 April 2014 the parties have agreed that the cost of repairs at the antecedent valuation date (AVD) was £442,431. They have, however, been unable to agree whether a hypothetical landlord would have considered that such repairs were uneconomic. I have received written submissions from both parties on that issue.

59. Ms Denly said that the hypothetical landlord would weigh up the likely level of income and the prospect of receiving this over time as compared to the necessary expenditure on repairs. The judgment would have regard to the style of and demand for the property. If prime, the considerations were likely to be different from what they would be if the property were tertiary. That, she said, was the approach postulated by the Valuation Tribunal in *16/18 Princess Street (Ipswich) Ltd* v *Bond (VO)* 2002 RA 212.

60. The landlord's decision would have been made in the economic climate at 1 April 2008 which, Ms Denly said, was generally considered to have been before the recession had a substantial impact on the commercial property market. The collapse of Lehman Brothers in September 2008, the announcement by the Bank of England of an official recession, the collapse of Bradford and Bingley Building Society and the acquisition of HBOS by Lloyds Bank all took place well after the AVD.

61. In order to decide whether the repair costs were economic it was first necessary to ascertain the rent which would be agreed if the appeal property were not repaired. If the hypothetical parties would only agree a small rent reduction it was probably not worthwhile for the landlord to undertake the repairs. If the reduction below the full "repaired" rent was large, the landlord might decide that it was worth carrying out the works. The decision would depend on the income flows and costs, including how long the landlord could expect to receive the income.

62. In para 50(iii) of its interim decision the Tribunal found that the life of the appeal property following the repairs would be at least 60 years. Factually the appellant continued to occupy the property in its unrepaired state for over two years after the material day, although it was not clear how long it could realistically have continued in occupation given that the property would continue to deteriorate over time. For the purposes of the current exercise Ms Denly assumed that occupation of the unrepaired property could have continued for five years. Certainly it was occupied from 2007, when the appellant first started to consider undertaking works of repair, until 2012 and it was likely that occupation could have continued for longer.

63. Ms Denly prepared three calculations to show the present value of the hypothetical landlord's interest at the AVD on the assumption that no repairs were carried out. Each calculation assumed that the tenant would continue in occupation for five years. The assumed reductions in rent to reflect the disrepair were, respectively, 50%, 10% and nil. In each case Ms Denly capitalised the rental income at 10%, the rate adopted by Mr Bevan in the calculation referred to in paragraph 17 of the interim decision. Ms Denly also calculated the present value of the hypothetical landlord's interest assuming he would undertake the repairs and then obtain the full rent of £78,500 per annum over the 60 year life of the appeal property, again capitalising at 10%.

64. The net value of the property in a repaired state, after allowing for the cost of those repairs, exceeded the present value of the landlord's interest in each of the three scenarios in disrepair. The differential was particularly marked if the rent was reduced by 50%.

65. Ms Denly said that her understanding of the principle of *rebus sic stantibus* meant that the hypothetical landlord did not have the option of redeveloping the site. Either he repaired the property and let it or he held it in disrepair (or conceivably carried out some minor repairs only).

66. Ms Denly concluded from her various calculations that the repairs would be economic. She added that the hypothetical landlord also had the option of letting the appeal property as it stood and undertaking the repairs at a future date before a fresh letting. If the reduction in rent was only 10% then, depending on his attitude to risk, the hypothetical landlord might think that this was the economically sensible thing to do.

67. Ms Denly referred to the following rating cases dealing with the viability of repairs: *Saunders v Maltby (VO)* 1977 RA 109; *Dunham v Bellamy* EG Volume 240 p56; *Nicholson v Allsop (VO)* 1971 RA 177; *Foote v Gibson (VO)* RVR 6/83; *Various hereditaments at County Hall, Turnpike Road, Croesyceiliog, Cwmbran VTW/6945483734/204N00/1; Archer Ltd v Robinson (VO)* 2003 RA; and *16/18 Princess Street.*

68. Ms Denly recognised that previous tribunal decisions provided guidance on principles only and were not valuation precedents. Nevertheless, in her opinion a hypothetical landlord would have considered it economic to carry out repairs to the appeal property at a cost which was equivalent to 5.64 times the agreed RV. By so doing he would protect his main asset, the building, and could look forward to future net income once he had recouped his initial expenditure. Moreover, it was likely

that he would in fact achieve a higher rent than £78,500, since the repairs would add insulation to the property and make it more attractive to a tenant.

69. On the assumption that the Lands Chamber decided that the works were not economic Ms Denly turned to consider what reduction in the RV was appropriate. She said that the two questions were interlinked. The greater the reduction in rent, the more the chance that the landlord would undertake the repairs. She considered that any rent reduction in excess of 10% was likely to make the landlord decide to carry out the works.

70. Mr Bevan pointed out that on 14 September 2007 the Northern Rock obtained a liquidity support facility from the Bank of England, following problems in the credit markets. In 2008 the bank was nationalised. Both events preceded the AVD, the date at which economic conditions were to be assumed for the purposes of the valuation. In Mr Bevan's opinion the open market rental value of the appeal property, reflecting its disrepair and the general economic uncertainty, was "an optimistic £39,500."

71. Mr Bevan referred again to the 2010 RVs of the three neighbouring car showrooms, mentioned in paragraph 17 of the interim decision. All three premises accommodated sales of new and used cars and vehicle servicing, but Evans Halshaw included in addition an accident repair centre and its site area was twice that of the others. Evans Halshaw was therefore not a similar property.

72. Mr Bevan said that the RV of Capital Motors was £53,500 and that of Southern Merthyr was £42,500. The question, said Mr Bevan, was this: in the devastating economic conditions at the AVD would a reasonable landlord pay for repairs that would cost at least £662,431 (£442,431 plus interest of say £220,000 assuming 10% APR on a 10 year loan) to receive an additional rent of £3,000 (compared with Southern Merthyr) or £14,000 (compared with Capital Motors)? The answer would be no, because for ten years the potential additional rent would be less than the additional average repair cost of £66,243 per annum.

73. Mr Bevan said that the question could by repeated with the same result in relation to the VO's suggested RV of £78,500, because the potential additional rent of £39,000 would still be less than the additional annual repair cost.

74. In a response to Ms Denly's submission Mr Bevan made the following points. *Rebus sic stantibus* meant that the property must be valued as it was, assuming the same use as the existing use. The hypothetical landlord knew that the appeal property was used as a car franchise and located in a car franchise neighbourhood. It had a base rental value of £39,500 and the tenant would be obliged to maintain it in its existing state. The reasonable local landlord would only put the property into repair if the additional rent obtainable had the potential to generate an income greater than the total expenditure (including interest over 10 years) of £662,431. In this case the additional rent over 10 years would total £390,000 and the reasonable landlord would conclude, without calculating the net present value, that the repair was uneconomic.

75. Mr Bevan said that from 2007 onwards the appellant was unable to obtain access to funding of £250,000 because its bank manager advised that HSBC was no longer lending to the UK property market. The hypothetical local landlord would have been in the same position as the appellant. In addition to seeing photographs of queues outside the Northern Rock, he would have been able to read, on 3 March 2008, that British banks had lost £12 billion during 2007 and, on 21 November 2007, that the US sub-prime mortgage crisis had led to plunging property prices, a slowdown in the US economy, and billions in losses by banks. As a result the banks had a weaker capital base and were unwilling to lend to landlords. The expenditure on repairs was therefore uneconomic, because it was unfeasible.

Conclusion

76. The parties agreed that, in deciding whether the repairs were economic, the hypothetical landlord would have had regard to the rent which the appeal property would command if the works were effected. Ms Denly considered that rent to be £78,500, whereas Mr Bevan prepared two calculations assuming rental values of £53,500 and £42,500 respectively based on the RVs of neighbouring showrooms. He also prepared a third calculation, based on a rental value of £78,500, which he described as "the valuation office's preferred rent". In my judgment this issue can be resolved without difficulty. In reaching his decision the hypothetical landlord would not have had regard to rental evidence derived from different properties, albeit in the same general location and in similar use. Rather, he would have considered the value of the appeal property itself. Accordingly, his calculation would have incorporated a rental value of £78,500, which the parties have agreed to be the value of the appeal property in reasonable repair.

77. Ms Denly did not put forward a specific rental value based on the property's actual state of repair. Instead she prepared calculations, assuming that the disrepair would result in reductions of nil, 10% and 50%, without expressing a preference for any one. Mr Bevan considered that the value in disrepair was £39,500, a deduction of just under 50%.

78. Before deciding this issue I remind myself of Mr Bevan's unchallenged description of the appeal property's condition at the material day, reproduced in paragraph 9 of the interim decision. The condition at that time was extremely poor. In my judgment such a property would have been very difficult to let. The difficulties would, if anything, have been enhanced at the AVD when, as I find, economic conditions were deteriorating. Against that background I consider that Mr Bevan was probably right to describe his rental valuation in disrepair of £39,500 as optimistic, but in the absence of any more reliable evidence I accept it. The expenditure of £442,431 on repairs would therefore have resulted in an increased annual rent of £39,000 (£78,500 minus £39,500).

79. Ms Denly's calculations assumed that the "in disrepair" rental value would have been received for five years, whereas Mr Bevan's view was that it would have lasted for ten years. I prefer Ms Denly's estimate in view of the fact that, in answer to a question from me at the oral hearing, Mr Bevan said that a major problem could be expected if the roof continued in disrepair for five years.

80. Accordingly, the hypothetical landlord would have known that, if he did not carry out the repairs immediately, he would need to carry them out in no more than five years time. Meanwhile, the appeal property would be let, if at all, to a tenant who was prepared to occupy a building in very poor condition at a reduced rent. Such a tenant is likely to have been less reliable than one who could be secured if the property was in reasonable condition and there would be a real risk of rental voids during the five year period. Against that background I accept Ms Denly's opinion that the present value of the landlord's interest assuming the works were carried out immediately, less the cost of carrying them out, would have significantly exceeded the present value in disrepair.

81. I have not overlooked the fact that the appellant was unable to secure a loan to carry out the necessary works in April 2008. That is not conclusive, however, since another landlord might have been of stronger financial standing than the appellant, and thus found it easier to raise the necessary finance, whether from its own resources or otherwise. I am therefore unable on the evidence to produce a reliable cash flow calculation assuming a particular rate of interest on a loan, nor to conclude that the hypothetical landlord could not have afforded to carry out the works.

Result

82. I find that a reasonable landlord would not have considered that the works required to put the appeal property into repair were uneconomic. The appeal is therefore dismissed.

83. In appeals conducted under the Tribunal's simplified procedure an order for costs is only made in exceptional circumstances. No such circumstances arise in this case and I make no costs order.

Dated: 29 May 2014

N J Rose FRICS