IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2016] UKUT 497 (LC)
Case No: RA/11&13/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – valuation – 2010 Rating List – self-catering holiday units – receipts and expenditure method of valuation – fair maintainable trade - working expenses – depreciation - divisible balance – applicability of **Redrose v Elizabeth Thomas (VO) [2014] UKUT 0311 (LC) -** ***appeal allowed in part***

IN THE MATTER OF AN APPEAL FROM A DECISION OF THE VALUATION TRIBUNAL FOR ENGLAND

BETWEEN:

(1) BEACONSIDE COUNTRY HOUSE & COTTAGES **Appellant**

(2) RICHARD G M JONES

- and -

ALISON GIDMAN (VALUATION OFFICER) **Respondent**

Re: Beaconside, Monkleigh, Bideford, Devon EX39 5JL
and
Stowford Lodge, Langtree, Torrington, Devon EX38 8NU

- -

Before: Paul R Francis FRICS

Hearing date: 27 July 2016

Bristol Civil Justice Centre, Redcliff Street, Bristol BS1 6GR

- -

Alan R Morrish BA (Hons) MRICS IRRV for the appellants
Anthony Robinson BSc (Hons) MRICS, for the respondent Valuation Officer

The following case is referred to in this Decision:
Redrose Ltd v Elizabeth Thomas (VO) [2014] UKUT 311 (LC)

DECISION

Introduction

1. These are appeals by the ratepayers against a decision of the Valuation Tribunal for England ("the VTE") dated 22 December 2015 reducing the assessments in the 2010 rating list of two separate and unrelated self-catering holiday units ("SCHUs") in North Devon: Beaconside, Monkleigh, Bideford EX39 5JL and Stowford Lodge, Langtree, Torrington EX38 8NU. In respect of Beaconside, the decision determined that the compiled rating list entry of £30,500 RV be reduced to £25,000 RV with effect from 1 April 2010 (the figure argued for by the VO following his reconsideration of value against the appellant's proposal that it should be reduced to £18,500 RV). As to Stowford Lodge the rating list entry was reduced from £10,500 RV to £9,900 RV. The appellant had argued for a reduction to £8,100 RV whereas the VO defended the compiled list entry.

2. In these appeals, in which the issues relating to each of the two hereditaments are precisely the same, Mr Alan Morrish, a partner in Alder King LLP, Property Consultants (who had also acted in the appeals to the VTE), appeared for the appellant ratepayers. In his statement of case he sought £8,750 RV for Beaconside, this being further reduced to £7,950 RV in his expert witness report. For Stowford Lodge, he initially sought £3,800 RV, this being reduced to £3,650 in his expert witness report. Mr Anthony Robinson, a lead valuer in the Valuation Office Agency's Non Domestic Rating Central Group appeared as authorised respondent Valuation Officer ("VO"). He argued that the Rateable Value of Beaconside had been correctly determined by the VTE, as that was the sum that had been argued for by the VO, and that the revised RV for Stowford Lodge, being less than had been argued for, could not be described as excessive. Each of the experts also appeared as advocates. The appeal was conducted in accordance with the Tribunal's simplified procedure.

Facts

3. The parties produced a brief statement of agreed facts which indicated a broad accord as to what the two hereditaments comprised and confirmed the common view that the receipts and expenditure method of valuation was the appropriate methodology to use, given that there was no available comparable evidence relating to rental values for properties of this type. Although it had until just before the hearing been a matter that was in issue, the parties agreed the level of fair maintainable trade ("FMT") for Beaconside and Stowford Lodge at £135,000 and £55,000 pa respectively.

4. The Beaconside House and Cottages SCHU comprises a large and imposing detached Victorian house (c.1841) containing eight bedrooms, seven bathrooms and reception rooms including a dining room large enough to seat 18 people. There is an outside terrace and a barbecue area. There are also four smaller cottage conversions and the whole complex provides a total of 32 single bed spaces ("SBS"). There are a number of shared facilities

including heated indoor and outdoor swimming pools, a hot tub and children's play area, tennis court and boules lawn and the whole is set in 23 acres of private grounds with access to fishing on the River Torridge. Formerly a hotel, Beaconside has operated in its present guise since 2006 and is now a licensed wedding venue (although that licence had not been obtained at the AVD). The property is located in a rural setting in the village of Monkleigh, three and a half miles from Bideford and about six miles from the coast at Westward Ho!

5. Stowford Lodge consists of a complex of former farm buildings that has been converted into four self-contained holiday units together with a newly constructed detached log cabin (Tarka's Holt), and the whole offers 23 SBS. It occupies a site of six acres and there is a children's play area, wooded walks and a small indoor swimming pool. Great Torrington is within 3 miles and the coast is some 10 miles distant. The property is close to the Tarka Trail (from Henry Williamson's 1927 classic book "Tarka the Otter"), a long distance footpath and cycleway.

6. The parties agreed that due to the almost complete lack of comparable rental evidence, most SCHUs being owner operated freeholds, the Receipts and Expenditure method of valuation was the most appropriate methodology to adopt – that being accepted by the VTE in its determination.

Issues

7. The issues remaining in dispute on respect of both hereditaments are:

1. The level of working expenses that the hypothetical tenant would expect to incur. Although a number of heads had been agreed, the following remained in dispute at the commencement of the hearing:

   Beaconside: cleaning/staff costs; motor expenses; provisioning; land maintenance; depreciation.

   Stowford Lodge: insurance; cleaning; repairs; computer costs; motor expenses; consumables; sundries; subscriptions; depreciation; land maintenance.

2. Divisible balance. Whether or not the "normal" 50/50 apportionment of the difference between income and expenditure between tenant's and landlord's share should be varied (as it was in the Tribunal's decision in *Redrose Ltd v Elizabeth Thomas (VO)* [2014] UKUT 0311 (LC)). This issue had not been before the VTE.

The VTE decision

8. Having considered the evidence and arguments, the VTE set out its valuations thus:

Beaconside

FMT	£137,000		
Working expenses – including depreciation of non-rateable assets at £10,200		(£85,724)	
Divisible balance		£51,726	
Tenant's share (50%)		£25,863	
Landlord's share (50%)		£25,863	
RV (rounded) therefore			£25,000

Stowford Lodge

FMT	£55,000	
Working expenses including depreciation of non-rateable assets at £6,000	(£35,050)	
Divisible balance	£19,950	
Tenant's share (50%)	£9,975	
Landlord's share (50%)	£9,975	
RV – say		£9,900

The statutory provisions

9. The rateable value of a non-domestic hereditament is defined in paragraph 2(1) of Schedule 6 to the Local Government Finance Act 1988 ("the 1988 Act"):

> "2(1) 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."

10. Pursuant to the Rating Lists (Valuation Date) (England) Order 2008 [SI No 2008 No 216] 1 April 2008 is specified as the day by reference to which the rateable values of non-domestic hereditaments are to be determined for the purposes of local and central non-domestic rating lists which are to be compiled for England on 1 April 2010. This is the antecedent valuation date.

11. The procedure for determining the material day is defined in the Non-Domestic Rating (Material Day for List Alterations) Regulations 1992 [SI 1992 No 556] (as amended). It is the day by reference to which the physical matters to be assumed in the valuation are established. These are set out in Schedule 6, paragraph 2(7) (a) to (e) of the LGFA 1988.

> "(a) matters affecting the physical state or physical enjoyment of the hereditament;
>
> (b) the mode or category of occupation of the hereditament;
>
> (c) the quantity of minerals in or extracted from the hereditament;
>
> (cc) the quantity of refuse or waste material which is brought onto and permanently deposited onto the hereditament;
>
> (d) matters affecting the physical state of the locality in which the hereditament is situated or which, though not affecting the physical state of the locality, are nonetheless physically manifest there;
>
> (e) the user or occupation of other premises situated in the locality of the hereditament."

In this appeal the material day is agreed to be 1 April 2010.

The evidence

12. As I have indicated, the issues are common to both hereditaments, and for simplicity, I therefore proceed on the basis of discussing the arguments of principle and the parties' positions firstly as they relate to Beaconside and, having drawn conclusions thereon, turn to Stowford Lodge. I think it worth mentioning here that, in respect of the operating expenses in particular, it was clear the experts had reached an impasse to the extent that time was spent both in the preparation of their reports and before me at the hearing on specific items where I would have expected agreement to have been possible. For example, on Stowford Lodge, they were not prepared to compromise on whether the annual insurance cost should be taken at £1,250 (appellant) or £1,000 (respondent). In the appellant's accounts, the sums under this head were £1,336 for 2006/07 and £967 for 2007/08. I indicated that I was not prepared to spend time hearing argument where, in terms of the minimal effect that such a trifling difference would potentially have on RV, I would be entering that expense at £1,125.

13. Indeed, Mr Robinson, shortly before the hearing, had sent an open email to Mr Morrish that said *"I think we agree to disagree on these two cases and see no merit on narrowing the gaps as it will serve no purpose. I am sure my breakdown will only influence your valuation as much as your breakdown will influence my valuation so it is probably best to leave it to the*

LT." Those comments, in my view, reflect an uncooperative attitude that was unhelpful to the parties and the Tribunal.

14. For the appellants, Mr Morrish said that whilst it was agreed that the R&E method of valuation was appropriate on these hereditaments, and indeed other SCHUs, it was necessary to exercise some caution in respect of reliance upon accounts, particularly where, in relation to Beaconside, the information provided was not even based upon trading or profit and loss accounts, but upon a self-assessment tax form as provided to HMRC. That, he said in response to a point made by Mr Robinson that "*Surely the ratepayer would want to include all his relevant outgoings*" did not include non-cash items of expenditure such as depreciation. The decision in *Redrose*, it was argued, gives clear guidance on the use of actual accounts where it said, at paragraph 66:

> "When preparing an R&E valuation the accounts of the actual occupier must be studied with caution because they will not necessarily reflect the approach of the hypothetical tenant."

Nevertheless, in that case the Member, NJ Rose FRICS, concluded that subject to some exceptions the appellant occupier's accounts provided a more reliable approach to what the hypothetical tenant would adjudge the expenses to be than the methodology adopted by the respondent VO which reflected the alleged tone of rateable values based upon single bed spaces (SBS).

15. Mr Morrish said that actual trading or P&L accounts needed to be studied very carefully to come to a view as to their overall reliability in terms of what the hypothetical tenant might expect to achieve. The VO Rating Manual Volume 4, Section 6 said:

> "*2.1 Accounts and the hereditament*
>
> *The starting points for the valuation are the receipts and the expenditure of the actual occupier. It is, however, the profit potential of the hereditament that has to be established and not the profit achieved by the actual occupier. It is therefore essential to guard against the inherent danger of valuing the actual occupier's business rather than the hereditament itself, and it may be necessary to adjust the accounts accordingly."*

and

> *"3.1 General*
>
> *Copies of accounts will not in themselves necessarily provide sufficient information, or in a suitable form, to enable an accurate valuation to be made."*

16. The "RICS Guidance Note on the Receipts & Expenditure Method of Valuation for Non-Domestic Rating" states, at paragraph 5.1:

> *"Under the requirements of a valuation for rating it has to be assumed that the property is vacant and to let and that the occupation is that of a hypothetical tenant who is*

generally assumed to occupy the property for the purposes for which it is actually used. The nature of such hypothetical occupation may result in the need for adjustment of the facts relating to the actual occupation. In particular the impact of such hypothetical assumptions may need to be considered in respect of receipts, expenses and tenant's share aspects of the valuation which may require adjustment to accord with the legislative framework."

And at paragraph 5.5, continued:

"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. They may not always accord with the approach of the hypothetical; tenant."

17. Mr Morrish said that paragraph 5.28 of the Guidance Note set out the items of expenditure that might be deducted from the gross profit. In the light of the guidance and the fact that the accounts of Beaconside are not trading or formal profit and loss accounts, were prepared purely for self-assessment purposes and exclude items which would normally be included in an R&E valuation such as depreciation and employees' wages, and that the accounts were not in his view those of a typical operator, he had made such adjustments as he considered necessary to reflect all those heads which ought to be included.

18. He also provided details of comparable valuations, some of which he had agreed with the VO and others that resulted from decisions of this Tribunal or the VTE. Although he accepted that some of those valuations did not relate to SCHUs that were directly comparable in terms of their make-up, size and facilities and that each and every operation needed to be adjusted to reflect specifics, they were examples of what should and should not be included and added, in his opinion, considerable weight to his arguments.

19. Mr Robinson set out the three acceptable approaches to assessing RVs on SCHUs: Direct Rental Comparisons – where such evidence is available, but there is none in this case; the Percentage of Gross Receipts or "shortened R & E method" which draws upon an analysis of settled cases from the 2010 Rating list in terms of the percentage of gross receipts to be adopted and which was the method initially used in respect of these two hereditaments, and the full R & E method which is adopted when the shortened version is challenged and was thus agreed to be the appropriate route in these appeals.

20. In the case of SCHUs that, like Beaconside and Stowford Lodge, are being run as a fully operational holiday let business, Mr Robinson said it stood to reason that the actual accounts provide the best indication of what the achievable FMT and working expenses are. Nevertheless, there are often adjustments that need to be made to reflect particular circumstances, such as where the business is newly established, and greater than usual amounts are set aside for advertising whilst the business is becoming established and still growing. He said that in arriving at what was considered to be an appropriate FMT (which was agreed on the

two properties just prior to the commencement of the hearing), he also had regard to comparable operations in the Devon and Cornwall area in terms of FMT per SBS and, as a further sensitivity check had analysed settlements in relation to rateable value per SBS.

21. The sensitivity and comparables checks also applied equally to expenses and Mr Robinson said that he had relied on the appellant ratepayer's accounts information to make those assessments. He said that where no figures were shown in the operator's accounts against a specific head of expenditure, it was dangerous to import figures from other comparables or settled cases as they may not be appropriate in these particular circumstances.

22. Although the majority of the heads of expenditure had been agreed, the Tribunal's determination is required on the following:

Beaconside

Cleaning/Staff costs/Land maintenance

23. Mr Morrish pointed out that the self-assessment return made no allowance for cleaning costs and he understood that there may have been some cash payments made under this head. Mr Constantin (the VO before the VTE) had entered these costs at £13,700, this figure being 10% of his estimate of FMT of £137,000. This was accepted by the VTE as it was in accordance with the "normal" provision that had been accepted in the determination of a consolidated appeal relating to some 16 SCHUs where Mr Morrish had appeared for all the appellant ratepayers. Bearing in mind that the appellant's accounts information for Beaconside included £1,703 for laundry costs, Mr Morrish said he added this to the £11,800 cleaning costs to give an overall £13,503 – say £13,500 for cleaning and staff costs which was 10% of the now agreed FMT on this property. It would be unrealistic, he said, to expect the owners to clean and prepare 32 SBS themselves between say 11am and 4pm on changeover day and be on hand to greet new guests at the same time. If they do so, rather than pay outside staff, that effort should be reflected in the return.

24. A further £12,000 was included for the costs of maintaining the extensive formal gardens (3 acres) and paddocks/forestry land and riverbank (20 acres). The returns for 2006/07 showed these actual costs (cash expended) as £13,413 and for 2007/08 they were £11,202. Bearing in mind the importance of keeping up the appearance of these grounds, and maintaining/cleaning the swimming pool, a rounded average of these sums was not considered inappropriate.

25. Mr Robinson allowed the sum of £11,502 to cover all cleaning and land maintenance costs, together with £1,703 for laundry totalling (on a like for like basis with Mr Morrish's assessments) £13,505. He had not included land maintenance as a separate item as there was no such line in any of the accounts relating to comparable SCHUs. As to cleaning, he pointed out that whilst there were 32 SBS, 15 of them were in one unit of accommodation (the main mansion) and therefore time and costs could be saved as these 15 were all under one roof.

26. I prefer Mr Morrish's arguments on these issues. As was said in the VTE decision, cleanliness is of paramount importance and in such a large property it is in my view totally unrealistic to expect the owners to be able to run the business entirely on their own, without incurring some staff costs. I therefore accept Mr Morrish's figures under these heads and his argument that with this being such a substantial property and business which, at the AVD was still very much in its infancy, it is not surprising that expenses as a percentage of FMT can be expected to be higher than the average. Mr Robinson made the point that none of the comparables that had been considered had a separate line for land maintenance – even those with large amounts of land. However, he made much of the accounts information being the most appropriate avenue to explore in terms of expenses and I think therefore he was being rather inconsistent in then not taking those actually incurred costs into account.

Motor expenses

27. Turning to motor expenses, where Mr Morrish's £2,000 plays £900, Mr Robinson made the point that Beaconside might not be the appellant's only business and car costs could be shared with the owner's other activities. That may be the case for this operator (although no evidence was provided to support the VO's argument), but as far as the hypothetical tenant is concerned, it is most unlikely that the operation of Beaconside as an SCHU would be anything other than his sole occupation. Thus, he would wish to build in a more significant allowance than suggested by the VO, and I do not think Mr Morrish's figure appears at all unreasonable.

Provisioning

28. Provisioning had been allowed by Mr Morrish at £6,200 pa and he explained that in a property such as this where a large part of the accommodation would appeal to very large parties/groups, more extensive basic provisioning would be needed than in smaller units. His figure was exactly in accord with what had been spent under this head in each of the preceding two accounting years.

29. There was discussion at the hearing about the level of "Miscellaneous" items included within the VO's valuation at £6,500 against a more modest sum of £2,000 in that provided by Mr Morrish. Mr Robinson said that that figure included an allowance for provisions, and I suggested that £4,500 could be moved up to the provisions line to balance the miscellaneous figure out at £2,000 as an agreed amount. This left a difference of £1,700, however I determine that the £6,200 should be the correct figure as it is based upon two years actual expenses.

Depreciation (non-rateable assets)

30. Acknowledging that there was no such provision within the accounts information provided, because it related only to cash movements, Mr Morrish included, as set out in the VOA Rating Manual, Vol 4 s.16, the sum of £20,000 on the basis that there should be an allowance for tenant's non-rateable assets to reflect the capital he has invested in the enterprise such as costs of fitting out the units and provision of communally used equipment like patio heaters and barbecues. All will need to be replaced at some stage, and there is also the need to allow for depreciation to motor vehicles used within the business. Assuming a 5 year renewal cycle, £15,000 was allowed for this element. There was also the need to allow for repairs, renewals and replacements of such major items as boilers, swimming pools (of which there are

two), hot tubs and the like. A further £5,000 was therefore added for depreciation of these items and as a sinking fund for significant future maintenance costs. The total amounted to 14.8% of gross receipts and compared favourably, Mr Morrish said, with the comparables at Telehay (12%), Rosemoor (17%) and Tremaine Green (11%) where facilities and amenities are somewhat less than those at Beaconside.

31. Mr Robinson allowed £10,200 and said that a five year depreciation cycle was unrealistic and 10 years would be more appropriate. However, he did not specifically compare this head with other comparables, choosing instead to base his 'sensitivity checks' on other factors such as comparison of RV per SBS, as a percentage of FMT and on the hierarchy basis.

32. I tend to think that Mr Morrish's approach is more scientific, but I do agree that a five year replacement cycle would not be normally be adopted. Nevertheless, a figure of just over £10,000 pa seems to me somewhat light especially as there are a significant number of expensive pieces of equipment at Beaconside and the operator would be expecting to allow for some return on his not insignificant capital expenditure. On the assumption of a 10 year replacement cycle, I consider 10% of the FMT to be an appropriate figure, and therefore adopt £13,500 under this head.

Stowford Lodge

33. The R & E valuation in respect of this hereditament was based upon Mr Jones' unaudited trading accounts for the financial years ending 5 April 2007 and 2008. They related to the situation that prevailed before the addition of an extra unit that was added after the AVD. There had been four units totalling 18 SBS, and with the addition of Tarka's Holt there are now 5 units with a total of 23 SBS. As the valuation for rating purposes has to reflect the physical circumstances prevailing at the material day (1 April 2010), adjustments have to be made to the historical trading accounts. The 2008 turnover from 18 SBS of £43,000 equated to £2,390 per SBS. Adopting the same income per SBS for 23 units produces a 28% increase in gross receipts to £55,000, which was agreed to be appropriate as the FMT. A 28% increase in expenses from the 2008 accounts would produce £41,904, resulting in a profit of £13,096 for the five units.

34. However, Mr Morrish thought this approach to the working expenses was a "gross simplification" and said that as some adjustment to the accounts was in any event needed to reflect the position of the hypothetical tenant, he carried out a full R & E exercise. This achieved some minor economies of scale from the straight 28% increase set out above to produce total expenses of £40,309 leading to a profit of £14,691.

35. Mr Robinson said he had also relied upon the appellant's accounts and, other than the adjustments to account for Tarka's Holt, saw no reason to depart from them as a fair basis of assessment. Again, as with Beaconside, importing costs from other comparable assessments when the "actual accounts show the true situation" was considered unnecessary. His R & E valuation produced working expenses of £33,100 which left a profit (divisible balance) of

£29,100. On a 50/50 split between landlord and tenant, this suggested a rateable value of £10,750. The VTE's assessment at RV £9,900 was accepted by the VO as not therefore excessive and at 18% of FMT was well in line with the RVs agreed or determined on a number of comparables he produced.

36. The difference between the parties was, therefore, purely in respect of working expenditure and I turn now to the heads where agreement was not possible.

Insurance

37. As I indicated in paragraph 12 there was little at stake, and I determined that the difference should be split down the middle at £1,125.

Cleaning

38. Mr Morrish noted that the accounts for 2007/08 showed the sum of £1,932 as "wife's wages" and he was advised that that related to her cleaning duties. There was also a figure of only £702 under the heading "cleaning". The total of £2,634 to go against salaries, wages and N.I. was, he thought, insufficient especially as it did not include for the extra time and effort required for cleaning Tarka's Holt. He said that in almost every assessment that he had agreed with the VO on comparable SCHU's, and in the multi-hereditament case that had been decided by the Vice President of the VTE, this head had been accepted at 10% of turnover, and he thus entered £5,500 on this line. Mr Robinson said that this was too much, especially as Tarka's Holt was new and, not being pet friendly, would require less cleaning than the other units. He allocated £3,200 under thus head.

39. I am satisfied that, on the basis of the evidence from other assessments, there is no reason to conclude that less than the standard, widely accepted amount, should be taken. I thus enter this line at £5,500.

Repairs

40. The parties had been £500 apart but the appellant's figure of £4,500 was agreed by Mr Robinson.

Motor expenses

41. The motor expenses shown in the two years' accounts were at £6,735 and £3,716 respectively and Mr Morrish obtained information from the appellant as to the amount which the company vehicle was used. There had been some exceptional costs, so he entered that line at £2,500. Mr Robinson said that was still too high as the owners live on the premises and allocated £650. I do not agree. For the purpose of this valuation it cannot be assumed that the hypothetical tenant occupies the same accommodation as the actual operator unless that accommodation is also part of the hereditament. In any event, and bearing in mind the location

of the hereditament and the need for extensive use of a car or van, I think Mr Morrish's figure is entirely reasonable and I adopt it.

Computer, consumables, subscriptions and sundry/miscellaneous

42. Mr Morrish had included £245 for computer costs, £250 for consumables, £250 for sundry items and £500 for subscriptions amounting in total to £1,245. Mr Robinson had £1,250 for sundries and subscriptions. I therefore adopt that sum for all four items together.

Land maintenance

43. Mr Morrish allowed £1,000 for the maintenance of the six acres of grounds, but Mr Robinson said that there was nothing in the accounts under this head and there were a number of comparables, including Rosemoor, the Welsh property that was the subject of the *Redrose* appeal, that did not have such expenses. However, he acknowledged that he had not specifically inspected the accounts of the comparable properties.

44. Once again I disagree with Mr Robinson. £20 per week for the maintenance of such an important feature as the grounds is in my view an entirely reasonable, if not somewhat light, allowance particularly when considering the amount entered for Beaconside's land maintenance costs.

Depreciation (non-rateable assets)

45. The parties are only £1,500 apart with Mr Morrish adopting £8,000 and Mr Robinson at £6,500. The actual depreciation figures in the accounts were £6,207 for 2007/08 and £7,799 for the previous year. This is an average of £7,000 and I consider that figure to be fair, agreeing with Mr Robinson that Mr Morrish's suggested figure is higher, at 14.5% of turnover, than the amounts referred to in a number of the comparables.

Divisible balance

46. Whilst Mr Morrish acknowledged that the apportionment of the divisible balance between landlord and tenant had not been in issue before the VTE, and the "traditional 50/50 split had been agreed", he said that he had "been guided" by the UT (LC) decision in *Redrose Ltd v Elizabeth Thomas (VO)* [2014] UKUT 0311 (LC) (which had been published by the time of the VTE hearing in this appeal). The Tribunal (NJ Rose FRICS), determined that the divisible balance should be apportioned as to tenant's share 75% and landlord's share 25% because, in the circumstances of that case, a tenant taking a tenancy from year to year with no prospect of capital appreciation would not accept the low return for his efforts which a 50/50 split would produce. In Mr Morrish's view the circumstances of that case were very similar, and it would therefore be appropriate to take the same split in respect of both of the hereditaments in this appeal.

47. Mr Robinson pointed out that Mr Morrish had argued for a 50/50 split of the divisible balance before the VTE in this appeal and had also adopted the same percentages in the large VTE case relating to 16 SCHU's in Cornwall that he had referred to (Various persons v John Reeves (VO) – decision dated 27 October 2014), and which had taken place after the *Redrose* decision had been published. Thus, of a total of 24 comparables referred to in Mr Morrish's report, the only one with anything other than a 50/50 split was the *Redrose* case which was in respect of an SCHU in Pembrokeshire, where the market was very different. Further, Mr Morrish had not produced one shred of evidence to support his change of stance.

48. The reason, Mr Robinson said, for the split in the tenant's favour in *Redrose* was to reflect the extraordinary workload performed by the operators of the appeal property, and to provide a return that a prospective tenant might find acceptable for his efforts. The owners undertook laundry, cleaning, painting, plumbing and maintenance but none of these matters were allowed for in the accounts. In this case, those items had either been reflected in the appellants' accounts or, where not, had been allowed for by both the experts in their valuations. Indeed, he said that in his own R & E valuation he had adopted figures for the relevant working expenses that were in fact higher than had been shown in the accounts. Therefore, the adjustment to the divisible balance percentages represented double counting – a fact that Mr Morrish acknowledged in cross-examination could be the case.

49. In *Redrose,* the issue concerning the apportionment of the divisible balance between landlord and tenant was indeed, as Mr Robinson said, whether in preparing a valuation on the R & E basis the tenant's share of the divisible balance should be higher to reflect the considerable workload undertaken by the ratepayers and the modest total sum available as a return. The appellant ratepayer had argued that the cost of directors' salaries should be included in the total expenditure column of the R & E valuation to reflect the tasks performed by the directors which were over and above those that would normally be the case in such a business. He produced a valuation which, if the expenses were adjusted in the way he had suggested, the costs of running the business would be increased to £63,450. Assuming total receipts of £75,000 and a tenant's share of the divisible balance at 50% of the gross profit, the resulting rateable value would be £5,775. It was argued that if the appellant's excessive workload was not reflected in the total expenditure figure, the landlord's share of the divisible balance would have to be correspondingly reduced below 50%. If that reduction were not applied, the resulting effect would be to significantly increase the RV.

50. In his decision, whilst stating that the actual occupier's accounts as a general rule needed to be studied with caution because they will not necessarily reflect the approach of the hypothetical tenant, the Tribunal said that, apart from a couple of exceptions, the appellant's actual accounts in *Redrose* provided a more reliable approach than the information upon which the respondent VO had based her case. The R & E valuation which the Tribunal undertook, reflecting its decision on the exceptions, produced a divisible balance of £24,292. Turning to the apportionment the Tribunal said, at para 69:

> "… [the appellant] considered that assuming, as I have found, that the actual expenditure figures should not be increased to reflect the cost of employing outside labour for many

> of the tasks currently performed by him and his wife … the landlord's share of the divisible balance should be reduced below 50%."

The Tribunal went on to say, at para 70:

> "It is clear that [the appellant] and his wife work extremely hard. However, it is apparent from Mr Jones' [the appellant's expert] evidence on the subject, which I accept, they are not alone. Mr Jones said that self-catering operators
>
> > 'often work very long hours, for very modest financial rewards: a labour of love as some don't mind calling it.'"

51. There was also to be taken into account the motivation from the prospect of achieving a capital gain - the latest accounts of the appeal hereditament, following a professional valuation, showing a very substantial increase of the previously recorded valuation. The Tribunal said:

> "70. …In my judgment, to many SCHU operators the prospect of being able to dispose of their property at a profit at a later date will be one of the factors taken into consideration when deciding whether to accept the limited financial rewards which are immediately available to many participants in the industry. The chance of such capital gain however, is not available to the hypothetical tenant for rating purposes, who will only be granted a tenancy from year to year, albeit with a reasonable prospect of continuance.
>
> 71. If Ms Thomas is right, two people would be willing to work extremely hard operating the SCHU business at the appeal property for a combined wage of £12,146 per annum (50% of £24,292), in the knowledge that they will be unable to sell their interest in the property when their tenancy ends. That seems to me to be an unrealistic approach. I agree with [the appellant] that a tenant's share of 50% is too low. In my judgment, the tenant's share in the circumstances of this appeal should be 75% of the divisible balance, providing a joint annual income to the husband and wife (or other two person partnership) of £18,219."

52. After setting out his R & E valuation which produced an RV of £6,000, the Tribunal said at para 73 that:

> "In preparing this valuation I have adopted Ms Thomas's approach to directors' salaries. I have excluded them from total expenses on the grounds that the tenant's remuneration would be accounted for in the tenant's share."

53. In this appeal, there was also no allowance for directors' salaries, but some allowance has been made for matters undertaken by the operators themselves (e.g., an allowance for cleaning/laundry costs at Beaconside at 10% of FMT) and this needs to be reflected when considering the overall return enjoyed by the appellants. The question is: would the operators work for returns that effectively amount, if a 50/50 split in the divisible balance is taken, to just under 11% and just over 14% of FMT in the two hereditaments respectively (based upon the

working expenditure figures determined in accordance with the parties' agreement and my conclusions on the disputed items above)?

54. In the comparables that Mr Robinson produced to support his valuation on Beaconside, the agreed or determined RVs on four SCHUs which he considered to be very similar to the appeal hereditaments ranged between 17.2% and 19.%% of FMT, each based upon a 50/50 apportionment of the divisible balance. If the divisible balance is split on the 75/25 basis suggested by Mr Morrish, the resulting RVs become 5.37% and 7.1% of FMT respectively (see tables below).

55. If I were to determine that the divisible balance should be split 50/50 on the basis of the figures determined above, the rateable values would be, at 10.7% and 14.2% of FMT respectively, a lesser percentage than the range found in Mr Robinson's sensitivity checks from comparable SCHUs (17.2 to 19%). However this, in my judgment, is not the point. The crucial issue, as pointed out in *Redrose*, is that the rating hypothesis assumes a tenancy from year to year. At the end of this tenure, the lessee walks away with nothing. There is no anticipation that capital growth will provide an additional return to the tenant to supplement the income derived from the profits of the enterprise. So, if the tenant builds up an outstanding business, there is no benefit from the growth in the value of the freehold that these efforts have achieved.

56. The 'labour of love' expended in running the operation and the risks associated with the business therefore need to be reflected wholly in a reasonable annual profit. With the current 'traditional' system of dividing the divisible balance equally, 50% of any additional profit that the operator makes converts into an equal increase in rateable value. This cannot be right.

57. So, it is necessary in every case, once the FMT and working expenses have been established, to "stand back and look" and to ask what the hypothetical landlord and tenant would agree would be a sufficient return to reward those efforts. The correct answer is unlikely to be the same in every case. In the case of Beaconside, a divisible balance of just under £30,000 has been established. At 50% of this, the return to the tenant at about £15,000 pa (less than 10% of turnover) would seem on the face of it to be an unattractive level of return for the effort required. However, the allowance made for the cleaning costs at 10% of FMT including laundry which were not referred to in the accounts needs to be reflected also (which it was not in *Redrose*), and this has the effect of bringing the "return" up to a more realistic level of around £25,000.

58. I do not therefore consider that it is necessary to adjust the apportionment of the divisible balance in this case away from the 50/50 split that had previously been argued for. But, for the sake of clarity, I record here that if the additional allowances to the accounts argued for by Mr Morrish and accepted by me had not been incorporated, then it would have been necessary to adjust the divisible balance. To do so where such allowances have been made would indeed be double counting.

59. Turning now to Stowford Lodge, the divisible balance of this seemingly more straightforward operation amounts to 28.4% of FMT. The tenant's share, at 50% is therefore, at £7,812.50, 14.2%, which I consider to be a reasonable return. I therefore determine the rateable value at £7,800 with effect from 1 April 2010.

60. The valuations are set out below:

Beaconside R & E Valuations			
	Appellant	**Respondent**	**Agreed/UT(LC)**
FMT	£135,000	£135,000	£135,000 (Agreed)
Expenses			
Cleaning	£11,800	£11,502 (inc land maintenance)	£11,800 (UTLC)
Heat/light/water	£15,760	£16,873	£16,873 (Agreed)
Rates payable	£6,699	£6,500	£6,500 (Agreed)
Insurance	£2,400	£2,400	£2,400 (Agreed)
Petrol/car	£2,000	£900	£2,000 (UTLC)
Provisions	£6,200	-	£6,200 (UTLC)
Land maintenance	£12,000	- (inc in cleaning)	£12,000 (UTLC)
Telephone	£2,600	£2,697	£2,600 (Agreed)
Trade waste	£2,000	£2,000	£2,000 (Agreed)
Advertising	£6,500	£6,000	£6,000 (Agreed)
Sky sub/TV licence	£1,350	£1,200	£1,200 (Agreed)
Laundry	£1,700	£1,703	£1,700 (Agreed)
Professional fees	£1,200	£2,000	£2,000 (Agreed)
Repairs	£7,500	£10,000	£10,000 (Agreed)
Bank charges	£1,500	£2,500	£2,500 (Agreed)
Subscriptions	-	£500	£500 (Agreed)

Miscellaneous	£2,000	£6,200	£6,200 (Agreed)
Depreciation	£20,000	£10,200	£13,500 (UTLC)
TOTAL	£103,209	£83,175	£105,973
Divisible balance	**£31,791**	**£51,825**	**£29,027**
Landlord's share	@25% £7,948	@50% £25,913	@ 50% £14,513
Rateable value	Say £7,950	Say £25,000	**Say £14,500**

Stowford Lodge R & E Valuations			
	Appellant	**Respondent VO**	**Agreed/UTLC**
FMT	£55,000	£55,000	£55,000 (Agreed)
Expenses			
Rates payable	£2,786	£3,000	£3,000 (Agreed)
Insurance	£1,250	£1,000	£1,125 (UTLC)
Light & Heat	£6,500	£6,500	£6,500 (Agreed)
Cleaning	£5,500	£3,200	£5,500 (UTLC)
Repairs	£4,500	£4,000	£4,500 (Agreed)
Printing etc	£1,000	£1,000	£1,000 (Agreed)
Advertising	£3,000	£3,000	£3,000 (Agreed)
Telephone	£1,000	£1,000	£1,000 (Agreed)
Motor	£2,500	£650	£2,500 (UTLC)
Accountancy	£1,528	£1,500	£1,500 (Agreed)
Bank charges	£500	£500	£500 (Agreed)
Computer, consumables, subscriptions, sundries/misc	£1,245	£1,250	£1,250 (Agreed)

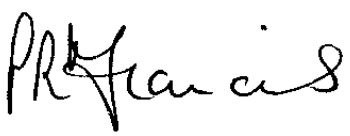
Depeciation	£8,000	£6,500	£7,000 (UTLC)
Land maintenance	£1,000	-	£1,000 (UTLC
TOTAL	£40,309	£33,000	£39,375
Divisible balance	£14,691	£21,900	£15,625
Landlord's share	@ 25% £3,673	@ 50% £10,950	@ 50% £7,821.00
Rateable value	Say £3,650	Accepts RV adopted by VTE £9,900	**£7,800**

61. I determine that the appeals shall be allowed in part and direct that the assessments of the appeal hereditaments be reduced to RV £14,500 (Beaconside) and RV £7,800 (Stowford Lodge) in the 2010 rating list with effect from 1 April 2010.

62. I would add in conclusion that these appeals, and the Tribunal's decision in *Redrose*, suggest that the adoption of a conventional 50/50 split of net profit before rent without considering critically whether the resulting figure properly reflects the sum at which the hereditament might reasonably be expected to let from year to year on the statutory assumptions, is unsound. Both *Redrose* and these appeals were conducted under the Tribunal's simplified procedure (which is appropriate for cases which raise no issue of valuation principle). It may soon be necessary for the Tribunal to address this issue under its standard procedure in order to give guidance on these important assessments.

63. As the appeals were conducted in accordance with the Tribunal's simplified procedure, costs are only awarded in exceptional circumstances. In my view, although some criticism has been made in this decision in respect of the experts clear lack of mutual co-operation, none of those matters are in my view sufficient to warrant an exception being made from the normal rule. I therefore make no order as to costs.

Dated: 7 November 2016



P R Francis FRICS