UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2020] UKUT 78 (LC)
UTLC Case Number: RA/27/2019

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – VALUATION – two floors of office building – tenant installing internal connecting staircase – reduction in net internal area – whether rateable value reduces pro-rata on floor area – whether staircase reflected in rateable value – appeal allowed – Rateable Value determined at £1,740,000 – Schedule 6 to Local Government Finance Act 1988

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

BY

DAVID JACKSON (VO) **Appellant**

Re: Office and premises
Pt 2nd Floor South and 3rd Floor,
10 Aldermanbury (55 Gresham Street)
London EC2V 6NQ

Peter McCrea FRICS and Mrs Diane Martin MRICS FAAV

12 March 2020

Royal Courts of Justice

George Mackenzie, instructed by the HMRC Solicitors for the appellant

The following cases are referred to in this decision:

Avison Young Ltd v David Jackson (VO) [2020] UKUT 58 (LC)
The Appeal of Manning (VO)[2014] UKUT 476 (LC)

Introduction

1. In this short decision concerning an unopposed appeal by the Valuation Officer ("VO") against a decision of Mr M.F. Young, Vice-President of the Valuation Tribunal for England ("VTE") given on 3 May 2019, the Tribunal revisits the second and third floors of 10 Aldermanbury (55 Gresham Street), recently the subject of its decision (Martin Rodger QC, Deputy Chamber President) in *Avison Young Ltd v David Jackson (VO)* [2020] UKUT 0058 (LC) dated 25 February 2020.

2. While the issue before the Tribunal in *Avison Young* was procedural, the appeal before us is simply one of valuation. In short, where two floors in an office building are connected by an internal staircase, installed by the actual occupier, which has the effect of reducing the net internal floor area, should the rateable value of the hereditament be based simply on the adjusted area, or should the benefit to the occupier of the floors being connected be reflected in the valuation?

3. As he did in *Avison Young*, Mr George Mackenzie of counsel appeared for the VO. Mr Michael O'Brien IRRV of the VO had provided a written expert's report, but was unwell and could not attend the hearing. The Tribunal accepted the VO's suggestion that Mr Karl List could attend the hearing to answer any questions that we might have, whilst not giving expert evidence. We are grateful to Mr Mackenzie for his carefully focussed and concise submissions, and to Mr List for providing background information. We indicated to Mr Mackenzie that we would be willing to hear from Mr O'Brien on another occasion, but by the end of the hearing neither he nor we considered that necessary.

4. In response to the VO's notice of appeal the ratepayer, Avison Young Ltd, indicated that it would be uneconomic to respond the appeal. In a letter, Mr Alex Stevens, Director, did point out some factual discrepancies in the VO's statement of case, which Mr O'Brien adopted in his expert report.

The facts

5. The appeal hereditament ("the premises") comprises the third floor and part of the second floor of 10 Aldermanbury, also known as 65 Gresham Street, a substantial office block in the City of London built in 1999 over nine upper storeys, and originally the home of J P Morgan.

6. On 3 June 2014 GVA Grimley Ltd ("GVA" – acquired by Avison Young in 2019) entered into an agreement to take a lease of the premises which included an obligation on the landlord to carry out works to fit them out to a Category A standard, and an obligation on the appellant to install an internal staircase linking the second and third floors. GVA installed the staircase at an apportioned cost of £164,000. The work to strip the premises out, install the new staircase, and refit the premises commenced on 1 September 2014. The lease took effect from 22 August 2014, for a term expiring on 7 June 2025.

7. Before the works were carried out the premises had a total floor area of about 4,598 sqm, comprising 1,133 sqm on the second floor, and 3,465 sqm on the third floor. After the installation of the staircase, the floor areas comprised 1,126 sqm on the second floor and 3,425

sqm on the third floor. The floor area lost to the staircase therefore amounted to 47 sqm: 7 sqm on the second floor, and 40 sqm on the third.

8. The premises were entered into the 2010 rating list, described as office and premises having a rateable value of £1,830,000, with effect from 16 June 2014, following a split of a previous list entry. As a result of the works, the premises became incapable of beneficial occupation on 1 September 2014, a situation which continued until practical completion on 23 January 2015.

9. The installation of the internal staircase was reflected in an alteration to the list by a valuation officer's notice by which the rateable value of the premises was reduced to £1,800,000 with effect from 1 April 2015. In *Avison Young*, the Tribunal upheld the Vice-President's decision dated 15 April 2019 in which he ordered that the rateable value of the premises be reduced to nil with effect from 1 September 2014, and restored to the rating list at £1,830,000 RV with effective date of 23 January 2015.

10. The appeal before us stems from a separate proposal by the ratepayer dated 22 July 2016, seeking a reduction in the rateable value of the premises on account of a further material change of circumstances ("MCC") which commenced on 1 May 2016 arising from the adverse effect of building work to the nearby 55 Gresham Street. The VO finding the proposal not well-founded, it was the subject of a second decision of the Vice-President dated 3 May 2019. In the context of that proposal GVA reconsidered the effect which the new staircase had on the rateable value of the hereditament and concluded that the appropriate valuation was £1,819,156. That figure was accepted by the VTE in an appeal arising out of the second proposal, and was used by the Vice-President as the starting point for an adjustment to reflect the MCC, agreed by the parties to have the effect of reducing the rateable value by 5%.

11. In the event, the Vice-President ordered that the rateable value of the premises be altered to £1,720,000 RV with effect from 1 May 2016.

The legislative framework

12. The basis on which the rateable value of a non-domestic property in England and Wales is determined is set out in Schedule 6 to the Local Government Finance Act 1988. It is to be assumed that the property is let on a tenancy from year to year, subject to certain assumptions about the terms of the notional letting and the date on which and circumstances in which it is taken to occur. For the purposes of this appeal, it is to be assumed that the appeal property was let at 1 April 2008 - the antecedent valuation date ("AVD") - but certain matters are assumed to be as they were at the material day of 1 May 2016, when the works to 55 Gresham Street began.

The basis of appeal

13. In short, the VO considers that the Vice-President was wrong to simply reduce the rateable value pro-rata to the reduction in net internal area. The addition of the staircase *must* have been of value to the actual occupier because they paid £164,000 to have it inserted and, on the VO's evidence, would have to spend £56,000 to have it removed. It would, the VO submits, also be of value to the hypothetical tenant. In the absence of any evidence to suggest that the

staircase would result in an increase in rental value, its insertion should be treated as value-neutral. The VO's position was therefore one of "no loss, no gain".

14. Mr O'Brien's expert report contained two alternative approaches to the valuation. The first stage, common to both approaches, involved applying to the reduced (post-work) net internal area a general rate of £400 per sqm, with £380 per sqm to the area without raised flooring, as follows:

Second floor:	1126.11 sqm @ £400 per sqm	£450,444
Third floor:	3383.99 sqm @ £400 per sqm	£1,353,596
Third floor:	40.82 sqm @ £380 per sqm	£15,512
		£1,819,552

15. In his first approach, he then added an element which represented an amortisation of the actual cost of installation, and a deferred cost of the actual tenant's obligation to reinstate, before finally applying the reduction of 5% for the MCC, to arrive at a rateable value of £1,750,000. For the reasons given below, we need not describe this approach in any further detail.

16. Mr O'Brien's second approach, and his primary case, involved simply adding back the notional rental value attributable to the missing floor area. That was based upon a simple premise – that rating is concerned with value to the occupier, and that in the real world the tenant would not have spent £164,000 in altering the floor plate and installing the staircase had the exercise not been of value to them. That work would equally benefit other office occupiers, including the hypothetical tenant on the statutory assumptions. The alterations should therefore be value-neutral, in the absence of any evidence to suggest that the rateable value should increase.

17. His valuation was therefore as follows:

	(from above)	£1,819,552
Plus value uplift for loss of stairs	46.81 sqm @ £400 per sqm	£18,724
		£1,838,276
Less agreed 5% MCC deduction		(£91,913)
		£1,746,363
	(say)	£1,745,000

18. Mr Mackenzie confirmed that in accordance with the VOA's rounding scheme, which rounds down to the nearest £10,000 for rateable values more than £1,000,000, the VO was contending for a rateable value of £1,740,000.

19. Mr Mackenzie acknowledged that the VO's case was not aligned with the decision of the Tribunal (Mr P R Francis FRICS) in *The Appeal of Manning (VO)* [2014] UKUT 0476 (LC), but in that decision the Member was unpersuaded on the evidence that the hypothetical tenant would pay more for the premises in question with a staircase than without it.

Discussion

20. We first consider the difference between reality and the hypothetical straitjacket imposed by the statute. For rating, we are to assume that the property is valued having regard to its physical characteristics at the material day – that is with the staircase in place, and the 47 sqm of net internal area having been removed. It matters not that this was, in the real world, a tenant's improvement (using that word neutrally for the moment). For the purposes of rating, the staircase belongs to the landlord, and is assumed to be in place at the commencement of the hypothetical letting at the AVD. There is no obligation on the hypothetical tenant to remove the staircase and reinstate the missing floor area.

21. Accordingly, we consider Mr O'Brien's first method of valuation, in which he amortised the cost of the installation of the staircase and the deferred cost of reinstatement, defective. Mr Mackenzie and Mr List very fairly accepted this and placed no reliance upon it. We would mention that, even had the approach been valid, it would be necessary to adopt the costs at the AVD, rather than those actually incurred by GVA at some point in 2014/15.

22. Leaving that aside, the point seems to us to be a fairly straightforward one. In essence, if an actual occupier is prepared to incur a significant sum in modifying a hereditament, should it be treated as having no rental value? We can imagine circumstances where some works are so bespoke and peculiar to an actual occupier that the hypothetical tenant would derive no benefit from them, and therefore be unwilling to pay any more in the putative negotiations.

23. As here, the insertion of a staircase and removal of some of the floor area is an increasingly common theme across London, and possibly further afield. We were provided with examples of other buildings where it has occurred. Equally, there is an increasing trend for provision of double or even triple-height receptions in modern office buildings, which have the effect of reducing net internal area, but for which there is plainly demand and, we would assume, a value to occupiers.

24. But, one of the difficulties in revaluations being infrequent is that, as in this case, market trends move on during the lifetime of a rating list. The common trends for this type of office building, are "statement" reception areas and internal connections affording access between floors without staff having to resort to common parts. These facilitate breakout areas, or three-dimensional meeting spaces where staff can sit on stairs or gather on galleried areas to be addressed by their superiors. The impacts on value are more easily captured in a later revaluation because the market has adapted to demand, and landlords and developers are themselves providing the product, rather than occupiers retro-fitting to achieve them. At revaluation the VO is therefore able, we assume, to capture rental evidence which forms the basis of the scheme of valuation for this type of office building.

25. But how should they be treated when, as in this case, that trend was little known or even unheard of at the AVD? We were not presented with any evidence showing transactions in the market in 2008. So, we are left in the position of having to parachute in to the AVD a physical

situation from a much later material day, resulting in a hypothetical letting of a property which might well have been a novelty. Mr Mackenzie accepted that this produced a tension.

26. We accept the VO's position that it simply can't be right that an alteration which has cost a significant sum would have been made had it not been of value to the actual occupier. The crucial point is whether the alteration would have been of value to the hypothetical tenant.

27. It is possible, but probably a contrivance, to analyse the VO's proposed figure on a net internal area basis. We calculate that the VO's proposed £1,740,000 equates to £398.54 per sqm for the main floorspace. On the reduced floor area, the same rateable value would equate to £402.64, – an increase of just over 1%. But we are not persuaded that hypothetical parties would negotiate to this level of detail. A more detached approach would be to consider whether the hypothetical tenant would pay £20,000 in rent for the benefit of the staircase.

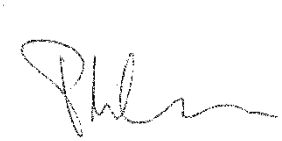
28. As in *Manning*, there is no evidence that the hypothetical tenant at the AVD would pay more for the whole premises with the benefit of internal stairs than without it. However, we are satisfied that the hypothetical tenant would not expect to pay less for the whole premises with the facility and security benefits that an internal staircase would bring, even had the building as configured been relatively novel at the AVD.

29. Accordingly, we allow the appeal, and direct that the premises be entered into the 2010 rating list with effect from the material day of 1 May 2016 at £1,740,000.

30. We were told that many similar cases are stayed at the VTE pending this decision. It is therefore appropriate to offer a final word of caution. The method of no loss – no gain might not be appropriate in all circumstances, and in our view cannot be stretched too far.

31. Take for example a situation where an actual tenant had removed a significantly larger floor area, say to create simply a narrow gallery surrounding a large atrium. In those circumstances it might be doubtful that the hypothetical tenant would be willing to pay a significantly higher rate per sqm on the reduced net internal area to the extent necessary to equal the rateable value before the work had been carried out. As ever, valuation is an art and not a science, and it will be a matter of professional judgment in each case.

32. The appeal being unopposed, we make no order for costs.



Peter McCrea FRICS FCIArb Mrs Diane Martin MRICS FAAV

24 March 2020