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Analysing the case law ■



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The valuer's conundrum

The recent Upper Tribunal decision in *Stephen G Hughes (VO) v Exeter City Council* [2020] UKUT 0007 (LC) addresses the method of valuation appropriate for a building in respect of which there is no direct rental evidence and where there is no profit motive. The case report contains a comprehensive review of the relevant case law and is expected to become the point of reference for the future in similar cases.

The Royal Albert Memorial Museum and Art Gallery in Exeter is housed in a Grade II listed building built in the 19th century, is not operated for profit and is expensive to maintain. It appeared in the 2010 rating list at a rateable value of £510,000 following completion of a major refurbishment project, later reduced to £445,000.

The ratepayer, Exeter City Council, had made a proposal to reduce the RV in response to the Upper Tribunal's decision in *Stephen G Hughes (VO) v York Museums and Gallery Trust* [2017] UKUT 0200 (LC), in which the Tribunal had determined the RV of the Yorkshire Museum in the 2010 list at £1. The contractor's basis of valuation was held not to be an appropriate valuation method in *York* and the VO did not appeal that decision. The Yorkshire Museum occupies a purpose-built 19th century building and is similar in many respects to the Exeter Museum.

The VTE's decision

Exeter had been successful in the VTE at reducing the RV of its museum and art gallery to £1 (the tribunal stated that application of the reality principle would not produce a positive rent for the premises on the open market). The panel's conclusion was that any socio-economic benefit to the area was **not shown to be sufficient to offset the financial burden** on the hypothetical tenant occupying the property as a museum. In short, the property could not reasonably be expected to have achieved a positive rent on an open market letting.

The Appeal to the Upper Tribunal

As part of the parties' preparation for the Upper Tribunal hearing, it was agreed that there were no direct rental comparables (although each expert considered a number of possible comparables, they did not assist in the valuation exercise). The alternative methods of indirect valuation were agreed to be:

- the contractor's basis ("CB", involving the adoption of a modern substitute); and
- the receipts and expenditure ("R&E") method. The CB method would have given an RV of £690,000 in the VO's opinion (capped at £445,000 under regulations applying to the 2010 list) or

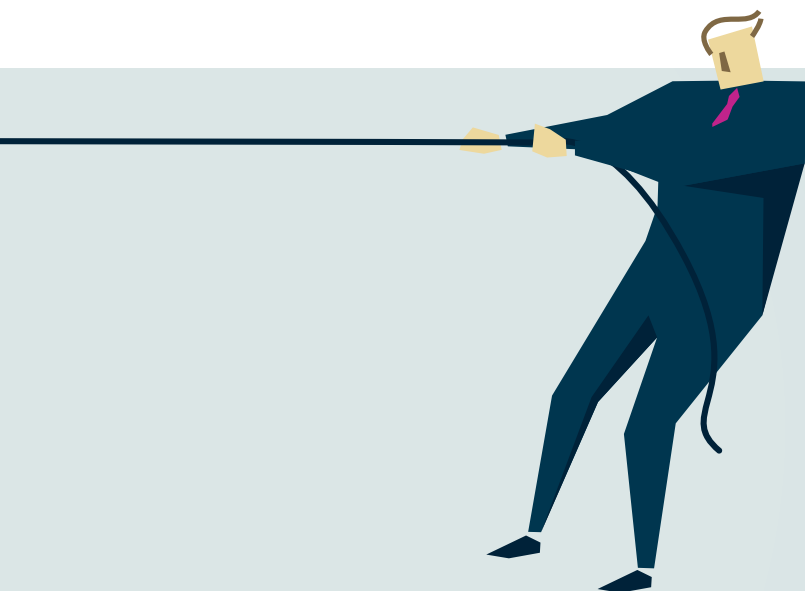
£430,000 according to the ratepayer's expert. By contrast, it was agreed that use of the R&E method would produce an RV of £1 (although the VO did not prepare a valuation by this method, arguing that it was inappropriate where the profit motive is absent).

The Tribunal's analysis

Faced with a choice of (indirect) valuation methods, the Tribunal took the opportunity to analyse the relevant case law as part of its deliberations as to which method was appropriate for valuing the Exeter Museum.

The Tribunal emphasised that the statutory hypothesis of a notional yearly tenancy in the Local Government Finance Act 1988 is only a mechanism to enable the valuer to establish the value of a particular hereditament, vacant and to let, for rating purposes. The valuer must not depart further from the real world than the hypothesis compels (*Hoare (VO) v National Trust* [1998] RA 391).

The Tribunal referred to the **"reality principle"** (a description adopted in *SJ&J Monk v Newbigin (VO) (RSA and another intervening)* [2017] 1 WLR 851) which rests on the fundamental objective of the rating hypothesis, namely to arrive at the real annual value of the occupation of the hereditament to a hypothetical tenant. The



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valuer must focus on the **“essential”** or “intrinsic” qualities or characteristics of the particular hereditament and ignore factors which are non-essential or **“accidental”** to the property.

The Supreme Court in *Monk (drawing upon Williams (VO) v Scottish and Newcastle Retail Limited* [2001] RA 41) referred to the physical state and user limbs of the reality principle, as set out in para 2(7) of schedule 6 to the 1988 Act. These include the mode or category of occupation, matters which affect the physical state or physical enjoyment of the hereditament, the use or occupation of other premises in the locality and matters affecting the physical state of the locality or (although not affecting the physical state) are nonetheless physically manifest there. These supplement the basic assumption that immediately before the hypothetical letting began on the antecedent valuation date (being 1st April 2008 for the 2010 list) the hereditament was in a reasonable state of repair (save for any repair which a reasonable landlord would consider uneconomic), whether or not that was in fact the case.

The starting point in the valuation exercise must always be to apply the principles referred to by *Scott LJ in Robinson Brothers (Brewers) Limited v Houghton and Chester le Street Assessment Committee* [1937] 2KB 445 (a High Court decision, subsequently confirmed on appeal by the House of Lords). The trial judge stated that the rent to be ascertained is the figure at which the hypothetical landlord and tenant would come to terms as a result of bargaining for that hereditament in the light of competition (or

its absence) in both demand and supply, this being the true rent as it corresponds to real value. Every factor, intrinsic or extrinsic, which tends to increase or decrease either demand or supply is economically relevant and, therefore, admissible evidence – these factors must equally be taken into account even where hereditaments are not in practice let and indirect methods of valuation have to be used. The key principle applicable in the Exeter case is that where the occupation of a property could not achieve a pecuniary profit (e.g. where a public authority occupies in performance of a public or statutory duty) that still represents a real demand for which a real value would be payable, but not an arbitrary sum higher or lower than the real value. No higher rental value must be assessed than the occupier would really be willing to pay for the occupation of the premises. The determination of such real value is a question of fact, not of law – there is no legal imperative as to the valuation method by which the value is to be ascertained.

The Tribunal endorsed the Robinson principles and referred to the *Supreme Court’s dicta in Hewitt (VO) v Telereal Williams* [2019] 1 WLR 1362 that the object of the legal hypothesis is to ascertain the value of the beneficial or profitable occupation of the subject property which requires the valuer to take into account **“all that can reasonably influence the judgement of an intending occupier”**.

Scott LJ in Robinson had pointed out that where the occupation of a hereditament has no commercial or pecuniary purpose,

its **“real value”** may be influenced by the performance of a public duty, or the pursuit of a purpose in the public interest. These **“public”** purposes were central to the dispute before the Tribunal in *Exeter*.

The Exeter reasoning

The main issue in Exeter was the method of valuation. The VO chose to rely solely on a CB valuation, but could have instead used an R&E valuation linked to the particular business or conducted a valuation by reference either to a percentage of gross receipts or a local authority’s overbid (to reflect the special motives of the authority as compared with a commercial operator). The Council’s expert, on the other hand, sought to rely solely on an R&E valuation. The Tribunal did not require the parties to consider other methods of valuation, but proceeded instead on the evidence before it, which set the valuation parameters.

The Tribunal carefully considered the appropriate factors which would influence the parties’ negotiations for the hypothetical letting, as an aid to determining which valuation method was appropriate. A key factor was whether the hereditament could be occupied to make a profit – it was accepted by the VO that the museum was never occupied for profit, but instead was occupied solely for socio-economic and cultural reasons. This led the VO to argue that the R&E method is wholly inappropriate and that only the CB method can be relied upon to assess the RV of the Exeter Museum.

As the freehold owner of a listed building, the Council has a legal responsibility to

maintain the museum which applies whether or not the building is put to beneficial use. It was held in *Hoare* that where these responsibilities are **very onerous** the hypothetical landlord would be glad to be relieved of them by granting a tenancy to the hypothetical tenant, leading to a nominal RV (in that case in respect of Petworth House and Castle Drogo, both National Trust properties). It was agreed between the parties that revenue to maintain the museum could only come from the Council's own resources (which were limited and subject to numerous competing demands). The parties also agreed that the Council was the only potential bidder – as in *Tomlinson (VO) v Plymouth Argyle Football Club Limited* (1960) 6RRC 173 (where the club faced no competition from others in the bidding process) the lack of competition meant there was no need for the Council to raise its (hypothetical) bid and that its ability to pay the rent became a valid consideration in determining rateable value. The Tribunal had before it evidence as to affordability and the Council's financial position, which clearly influenced the decision (as referred to below).

A major plank of the VO's argument had been that the R&E valuation method is appropriate only where a hereditament is occupied with a view to **making profits**, enabling the valuer to assess what rent the hypothetical tenant might reasonably pay in order to occupy the property to achieve those profits. The method should not be used where the motive for occupation is to obtain or promote social, economic or cultural benefits for the public. Where the accounts show a loss, there is under the R&E method a way of establishing the value of those benefits of occupation and, therefore, how much an occupier would be prepared to pay by way of rent.

The Tribunal did not accept the VO's argument that where the R&E method has to be rejected the CB method has to be used as the **"method of last resort"** (a label given to it in the past to reflect its potential weaknesses). It made clear that both the CB and R&E methods are indirect methods of valuation and there is no legal hierarchy between the two; it analysed relevant case law to answer the questions as to (1) whether the R&E method is indeed inappropriate for dealing with a hereditament not operated for

profit and (2) if the CB method faces similar challenges.

As part of a detailed review of legal precedent (including Scottish cases), the Tribunal referred to key decisions from the 1960s before considering the seminal decision of *Garton v Hunter (VO)* [1969] 2QB 37.

“Finally, the Tribunal considered the financial information provided by the Council, as set out in the statement of agreed facts. This gave an excess of expenditure over income of just under £1m ...”

In *Morecambe and Heysham Corporation v Robinson (VO)* [1961] 1 WLR 373 (involving beach facilities provided by the Corporation for public benefit but for which modest charges were made) the Lands Tribunal had stated that the R&E method is not to be ruled out as a valuation tool simply because it arrives at a modest profit, or indeed a loss. That outcome should form part of the overall circumstances taken into account in making a valuation judgement as to the level of rateable value. The decision of the Tribunal was confirmed by the Court of Appeal, which determined that a valuation incorporating an allowance for important socio-economic benefits was appropriate following an application of the R&E method, which was described as “permissible” for undertakings which share some of the characteristics of public utility undertakings. Harman LJ explained in *Morecambe* that the R&E method may be used where the occupier's motive is to *collect revenue* rather than solely to make a profit. Ultimately, the choice of method is one for the Tribunal so long as it leads to a valuation which meets the statutory criteria.

The Tribunal in *Exeter* drew the conclusion that “*there can be no objection in principle to the use of valuation judgment ... where the outcome of the R&E method is approximately nil or a modest deficit or even plainly a negative value*” and continued “*it is open to the valuer to assess whether the valuation significance of any relevant socio-economic benefits approximately equates to, or is less*

or greater than, the size of the R&E deficit, provided that all other factors affecting the rateable value are taken into account”.

In *British Transport Commission v Hingley (VO)* [1961] 2 QB 16 (involving Grimsby Docks, operated at a loss) the Court of Appeal found that the R&E method should be used, with an addition for socio-economic benefits to reflect the importance of the docks to the town. There was no legal basis for interfering with the Lands Tribunal's factual findings that the hypothetical tenant would consider the loss in operating the docks to be so significant that he would be justified in offering no rent.

Garton was concerned with the methods of valuation appropriate for a caravan site, where there was some direct rental evidence. The Lands Tribunal had adjusted the rental evidence to determine the RV, rejecting both the CB and R&E methods. The Court of Appeal allowed the VO's appeal (the VO had used the R&E method) as there were no comparables and caravan sites were not often let and remitted the matter to the Tribunal so it could evaluate the evidence on each of the three methods (rental, CB and R&E). In its further decision (reported at [1969] 15 RRC 145) the Tribunal held that **all three methods are legitimate ways** of seeking to arrive at a rental figure that would correspond with an actual market rent on the statutory hypothesis – “*if properly applied all three should in fact point to the same answer; but the greater the margin for error in any particular test, the less the weight that can be attached to it*.” The Tribunal decided to attach considerable weight to the R&E valuation, less to the rental evidence and very little weight to the CB valuation.

The Tribunal did not deduce any matters of principle from Scottish cases to assist in the *Exeter* case.

Turning to more recent decisions, the Tribunal noted that in *Hoare* neither party had argued for the CB basis and the Court of Appeal held that the maintenance costs were such that the hypothetical tenant would not be prepared to offer any rent. In *Eastbourne Borough Council v Allen (VO)* [2001] RA 273 (involving local authority sports centres) no profit was made but the CB method was accepted by the Lands Tribunal as the authorities had recently constructed the buildings themselves. That method was

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confirmed as suitable for purpose-built, relatively recent, public facilities.

The VO in *Exeter* submitted that York had been wrongly decided in that it rejected the CB method in favour of the R&E method and arrived at nil valuations for hereditaments occupied for socio-economic purposes. The Tribunal confirmed that it had correctly directed itself in *York* in that the ascertainment of the rent at which a hereditament might reasonably be expected to let on the statutory hypothesis is fundamentally a question of fact, not law. The selection of the valuation technique is a matter of valuation judgement. In summary, the conclusion reached by the Tribunal was that York had been correctly decided and that the VO's argument (as to the exclusion of the R&E method in a not-for-profit scenario) was not supported by any legal or valuation principle.

For completeness, the Tribunal considered three indirect rental comparables referred to by the VO (which had not been referred to in the York case). These were Tate Liverpool, The Design Museum in London and the Saatchi Gallery. For varying reasons, they

were found to be of no assistance in the valuation exercise but the Tribunal expressed surprise that the experts had both adduced so much rental and (to a lesser extent) settlement evidence. None of it was directly relevant but the experts used it to support their respective choices of valuation method.

Finally, the Tribunal considered the financial information provided by the Council, as set out in the statement of agreed facts. This gave **an excess of expenditure over income** of just under £1m and the Tribunal commented that it did not see how an RV exceeding £1 could be justified. It was critical of the parties in their failure to explore alternative valuation approaches by reference to trading potential, e.g. a percentage of revenue or an overbid – “*we think the experts failed to consider properly the totality of the circumstances and conditions under which [Exeter Museum] was occupied and therefore did not fully consider the value of the occupation to the hypothetical tenant.*”

The Tribunal analysed the parties' respective CB valuations within each of the 5 stages and concluded that the “stand back and look” requirement at Stage 5 led to the

core question as to whether the tenant's responsibilities were so great that occupation of the museum was in fact burdensome and therefore would not command any positive rent. The VO's CB expert made no Stage 5 allowance, having considered layout disadvantages at Stage 2 (the ratepayer's expert allowed 15% for layout plus a 6% allowance for higher insurance costs). A detailed analysis of the CB valuations is beyond the scope of this article but both the experts' and the Tribunal's valuations are set out in Appendices to the decision.

Overall, in the Tribunal's judgment the evidence pointed unequivocally towards the conclusion that the tenant's responsibilities were **too great** to validate more than a nominal valuation under the statutory formula. The Tribunal therefore dismissed the appeal and upheld the VTE's decision that the RV of the museum should be £1 with effect from 1st April 2015.

The VO is seeking leave to appeal the Tribunal's decision to the Court of Appeal.

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