Editorial

The Potential Impact of Business Rates on Landlords' Schemes of Development: If at First You Don't Succeed ...

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Business premises; Commercial development; Rateable value; Redevelopment

Rating may not be an integral part of many a landlord and tenant practitioner's practice, but the issue of rateable value has a far wider significance for many landlords than calculating the amount of statutory compensation payable to a tenant under the Landlord and Tenant Act 1954 Pt 2 and remembering to consider the impact of the revaluation as at 1 April 2017. In particular, rating should always be borne well in mind in circumstances where a landlord faces the expiry, or sooner determination, of a commercial lease and needs to plan for the redevelopment of their premises.

The Supreme Court's recent decision to reverse the Court of Appeal in the rating case of *SJ & J Monk (A Firm) v Newbigin (Valuation Officer)* [2017] UKSC 14; [2017] 1 W.L.R. 851 is, therefore, very important. Lord Hodge (with whom the other Justices agreed) asked and answered the question: "Does a commercial building which is in the course of redevelopment have to be valued for the purposes of rating as if it were still a useable office?". A question Lord Hodge described as of general public importance to the law of valuation.

The appellants, SJJM, owned the freehold of an office building constructed in the 1990s. In the past, the first floor premises were occupied by tenants as a single office suite. In 2006, the tenants vacated and, in December 2009, SJJM accepted the surrender of the lease of the premises. SJJM entered into a contract in March 2010 for the renovation and improvement of the premises with a view to making them more adaptable for use as either three separate suites of offices or as a single suite. SJJM's aim was to attract replacement tenants. The works comprised the removal of all internal elements, except for the enclosure of the lift and staircase, and included stripping out the internal and external plant, the lighting and power installations, the fire alarm system, the suspended ceiling, all sanitary fittings and drainage connections, the joisted and raised flooring and existing masonry walls and stud partitions. New common parts were to be constructed to the premises and new sanitary facilities, new drainage and plumbing, new electric lighting and a new alarm and heating systems were to be installed. Three new letting areas were then to be constructed.

The premises were described in the 2010 rating list as "offices and premises" with a rateable value of £102,000. Throughout the period to 6 January 2012, SJJM marketed the premises as available for letting as three separate office suites or as a whole. On 6 January 2012, SJJM's agents proposed to the respondent, the valuation officer, that the description of the premises for rating should be altered, with effect from 1 April 2010, to "building undergoing reconstruction" and that the rateable value should be reduced to £1. Accordingly, 6 January 2010 was the "material day" for the purposes of the rating legislation. As at 6 January 2012, the premises were

vacant. The contractors had carried out substantial works under the contract, but significant works remained to be completed.

The Local Government Finance Act 1988 (as amended by the Rating (Valuation) Act 1999) para.2(1) of Sch.6 provides that the rateable value of a non-domestic hereditament should be taken to be an amount equal to the rent at which it was estimated it might reasonably be expected to be let on three assumptions. These include that, immediately before any tenancy began, the hereditament was in a state of reasonable repair but excluding from that assumption any repairs which a reasonable landlord would consider uneconomic.

SJJM's reasoning that the rateable value be reduced to £1 was as a result of a material change in circumstances. It argued that the premises were undergoing a scheme of refurbishment which rendered them incapable of beneficial occupation. However, neither the Valuation Officer nor the Valuation Tribunal for England accepted SJJM's argument.

The Upper Tribunal allowed SJJM's appeal, holding that the premises had been stripped out to such an extent that to replace its major building elements would go beyond the meaning of repair, but the Court of Appeal reversed this decision and supported the Valuation Officer. Importantly, in the light of the Court of Appeal's ruling, the Valuation Office then amended its guidance pending further appeal. Emphasising the interest generated by the progress of the case, the British Property Federation and the Rating Surveyors Association were given permission to intervene and to make submissions on SJJM's appeal to the Supreme Court.

In allowing the appeal, the Supreme Court held that the long established "reality principle" of rating law continued to be fundamental under current legislation and is manifested in particular in para.2(6) and (7) of Sch.6 to the Act. As stated by Lord Buckmaster in *Poplar Assessment Committee v Roberts* [1922] 2 A.C. 93, that principle is that:

> "... although the tenant is imaginary, the conditions in which his rent is to be determined cannot be imaginary. They are the actual conditions affecting the hereditament at the time when the valuation is made."

The two limbs of the reality principle are the physical state of the premises and its use. Accordingly, Lord Hodge summarised the correct approach as follows:

1. to determine if the property is capable of rateable occupation at all and thus whether it is a "hereditament";
2. if the property is a hereditament, to determine the mode or category of occupation; and then
3. to consider whether the property is in a state of reasonable repair for use consistent with that mode or category.

The first and second questions involve the application of the reality principle. The third question requires the Valuation Officer to apply the statutory assumption regarding the state of repair of the premises if the reality is otherwise. In determining whether the property is undergoing reconstruction rather than simply being in a state of disrepair, the subjective intentions of the freehold owner are not relevant. The question is to be answered objectively, but in carrying out that objective assessment the valuation officer can have regard to the programme of works which is actually being undertaken. If the works are objectively assessed as involving such redevelopment, there is no basis for applying the statutory assumption to override the reality principle and to create a hypothetical tenancy of the previously existing premises in a reasonable state of repair.

On the facts, the premises had largely been stripped out in the course of a redevelopment and an outline of the future development had been created. The premises were incapable of beneficial occupation because, as an objective fact, they were in the process of redevelopment and no part of them was capable of beneficial use. There was, therefore, no basis to apply the assumption in order to create a hypothetical tenancy of the previously existing premises in a reasonable state of repair. As Lord Hodge noted, the hypothetical landlord of a building undergoing redevelopment would normally not consider it economic to restore it to its prior use. In the circumstances, the rating list could, therefore, be altered to reflect that reality.

A decision the property industry has widely welcomed.