**UPPER TRIBUNAL (LANDS CHAMBER)**

**UT Neutral citation number: [2019] UKUT 0136 (LC)**
**UTLC Case Number: RA/33/2018**

**TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007**

***RATING – Hereditament – two floors in office building stripped to shell - whether assumed to be in a state of repair or a "building undergoing reconstruction" – agreed to be incapable of beneficial occupation - Para 2(1)(b), Sch 6, Local Government Finance Act 1988 - appeal dismissed***

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

**BETWEEN: DAVID JACKSON (VO) Appellant**

**and**

**CANARY WHARF LIMITED Respondent**

**Re: Floors 45/46,**
**One Canada Square,**
**Canary Wharf,**
**London, E14 5AB**

**Martin Rodger QC, Deputy Chamber President and Peter McCrea FRICS**

**Royal Courts of Justice**

**9 April 2019**

*Sarabjit Singh QC,* instructed by HMRC solicitor's office, for the Appellant
*Daniel Kolinsky QC and Luke Wilcox,* instructed by Bryan Cave Leighton Paisner LLP, for the Respondent

The following case is referred to in this decision:

*SJ & J Monk v Newbigin (Rating Surveyors Association and another intervening)* [2017] 1 WLR 851

*Benjamin v Anston Properties* [1998] 2 EGLR 147

## Introduction

1. One Canada Square, an iconic tower of over 1.2 million square feet of office space across 46 storeys, forms the centre piece of the Canary Wharf estate and is a well-known London landmark. Upon a tenant moving out, it has been the owner's practice to strip out and market the vacant space in a shell state, with a view to it being fitted out at a later date to a new tenant's requirements. As part of that regime the 45th and 46th floors of the tower, with which this appeal is concerned ("the appeal property"), were in a shell state and incapable of beneficial occupation between 17 February 2011 and 30 November 2014.

2. The question in this appeal is whether the appeal property should be valued for rating purposes as offices in an assumed state of repair, as the appellant Valuation Officer ("VO") contends, or in its actual condition as premises undergoing redevelopment, as the respondent maintains. If the former, it is agreed the rateable value is £1,830,000; if the latter, it is agreed that a nominal rateable value of £1 should be shown in the list (in accordance with the practice of reducing the rateable value of a building which is incapable of rateable occupation because of temporary works, to a nominal figure rather than removing it from the rating list altogether.) The basis of the dispute between the parties is their differing interpretations of the Supreme Court's decision in *SJ & J Monk v Newbigin (Rating Surveyors Association and another intervening)* [2017] 1 WLR 851.

3. The appeal is against a decision of the Valuation Tribunal for England ("VTE") dated 16 March 2018, in which it determined a rateable value of £1. The respondent ratepayer is Canary Wharf Ltd, part of the Canary Wharf group of companies. The VO was represented by Sarabjit Singh QC, while Daniel Kolinsky QC and Luke Wilcox appeared for the respondent.

4. Written evidence was submitted from three witnesses: Mr Trevor Dingle MRICS for the Valuation Officer; Mr Digby Flower MRICS, the chairman of UK and Ireland at Cushman and Wakefield, and Angela Morgan, a Leasing and Project Executive employed by the respondent. None of that evidence was challenged.

5. At the conclusion of Mr Singh's submissions, we dismissed the appeal, and now provide our reasons.

## Facts

6. Canary Wharf was developed in the 1980/90's and is now a well-established office location with good public transport connections. Its occupiers are generally large corporate tenants in the financial services sector. Office accommodation across the estate is relatively homogenous in age and construction, comprising high-rise buildings providing large, open plan floorplates around central service cores.

7. One Canada Square is the tallest of the Canary Wharf buildings. It has 50 floors, of which the upper 46 comprise office space. Tenants mostly occupy whole floors; only five of the 46 floors are multi-occupied. The internal specification varies – floors occupied under leases granted in the 1990's are fitted out to a more dated standard than those let more recently.

8. The respondent is a subsidiary of Canary Wharf Holdings Ltd. The group has an in-house contractor, Canary Wharf Contractors Ltd ("CWCL"), which carries out stripping out and fitting out works for the group itself and for incoming tenants.

9. As One Canada Square is a multi-occupied building, the respondent does not have the opportunity to modernise it in its entirety. Instead a rolling programme of refurbishment and renewal is carried out as individual floors or groups of floors come back in hand on the expiry of leases.

10. When an unmodernised floor falls vacant, it is the respondent's policy to strip it out and market it in a shell condition. The new incoming tenant is then given an allowance to fit-out the space to a minimum standard. Most occupiers have more sophisticated fit-out requirements of their own so that the minimum standard is often not implemented in practice, but it is the basis of allowances and assumptions made for the purpose of rent review and future dilapidations liability. If the incoming tenant chooses to engage CWCL to undertake works on its behalf, all work is completed as part of a single programme. CWCL often carries out work to upgrade service installations and common parts, usually at the same time as fitting out.

11. The previous occupier of floors 44, 45 and 46 surrendered its lease on 17 February 2011. The floors had not been comprehensively refurbished for 20 years and, in anticipation of the space becoming vacant, CWCL was instructed on 20 January 2011 to strip out the floors to a shell and core condition. The works were carried out between 14 February and 18 September 2011, and involved the removal of raised flooring, suspended ceilings, partition walls, and mechanical and electrical services, at a cost of £740,254. Additional expenditure of £42,852 was incurred in stripping out the common parts of the three floors, comprising lift lobbies and wc's. As part of the work, new fire-detection systems and sprinklers were installed. The opportunity was also taken to introduce an element of future-proofing, in the form of a new riser which was added to the core to accommodate any additional mechanical or electrical infrastructure that might be required in the future.

12. Marketing of the three vacant floors commenced in February 2011. It is specifically accepted by the VO that at the material day in this appeal, 16 January 2013, the appeal property was fully stripped out to a concrete shell and was incapable of beneficial occupation as an office.

13. In late 2013 the respondent began negotiations with the European Banking Authority for it to take a lease of floor 46 and part of floor 45. An agreement for lease was entered into on 14 May 2014 and CWCL was then employed by the new tenant to carry out the required fit-out works. Following completion of these works the new lease commenced on 8 December 2014. The remainder of floor 45, which had been fitted out to the minimum standard as part of the same programme, remained vacant and available to let until 1 July 2015 when an agreement for lease was entered into with a new tenant, which was completed on 1 September 2015.

14. On 16 January 2013 the respondent made a proposal to alter the rating list to show the rateable value of the appeal property as £10 with effect from 17 February 2011.

**The statutory valuation assumptions**

15. The statutory rating hypothesis is well known. The subject of the valuation is a hereditament i.e. a unit of property which falls to be shown as a separate item in the valuation list (section 64(1), Local Government Finance Act 1988). The rateable value of a hereditament is equal to the rent at which it is estimated it might reasonably be expected to let for a tenancy from year to year on the three assumptions in paragraph 2(1) of Schedule 6, 1988 Act. The second of those assumptions is that immediately before the tenancy begins the hereditament is in a state of reasonable repair. This assumption modifies what is otherwise an established principle of rating law, the reality principle, one aspect of which is that a hereditament is to be valued as it in fact existed at the material day (the other aspect being that the hereditament is in the same mode or category of occupation as on the material day). There is excluded from the requirement to assume a reasonable state of repair any repairs which a reasonable landlord would consider uneconomic; to that extent only the hereditament is valued in its actual condition, rather than in an assumed condition.

16. Where a rateable value is to be determined with a view to making an alteration to a rating list which has already been compiled, paragraphs 2(6) and 2(7) of Schedule 6 also require that matters affecting the physical state or physical enjoyment of the hereditament, and the mode or category of occupation of the hereditament, must be taken to be as they are assumed to be on the material day.

17. The material day for the purpose of this appeal is agreed to be 16 January 2013, that being the date of the respondent's proposal.

**The Supreme Court's decision in *Monk***

18. *Monk* concerned an office building in Sunderland, known as Avalon House, which had previously been occupied by a single tenant. When the building became vacant the owners, S J & J Monk ("SJJM"), entered into a building contract for the renovation of Avalon House to make it suitable for use either as three separate office suites or as a building in single occupancy. It was contended by the valuation officer that the building should be assumed to be in a state of complete repair. The Court of Appeal agreed with the VO and reversed the decision of the Tribunal (Mr A J Trott FRICS) which had been that the hereditament should be entered in the rating list at a rateable value of £1 with the description of "building undergoing reconstruction".

19. In paragraphs 3 and 4 of the Supreme Court's decision, Lord Hodge described the work comprised in the building contract. It involved the removal of all internal elements, except for the enclosure for the lift and staircase. The cooling system, lighting and power installations, fire alarm system, suspended ceiling, sanitary fittings and drainage connections, raised flooring, and existing masonry walls and metal stud partitions were all to be stripped out. The contract also provided for the construction of new common parts and new communal sanitary facilities. It then envisaged the construction of three new letting areas within the premises with three self-contained electrical distribution circuits and air conditioning and heating systems.

20. On the material day the premises were vacant. The contractors had removed the majority of the ceiling tiles and the suspended ceiling grid and light fittings as well as 50% of the raised floor. The cooling system, electrical wiring and sanitary fittings had been stripped out, and the

block walls of the lavatories had been demolished. Plasterboard partitions to form the outline of the proposed communal lavatories and a partition across the floor at the east side of the premises had all been erected and plastered. First fix electrical installations had been completed in the lavatory area and the drainage had been altered to accommodate the new lavatories.

21. The argument in *Monk* focussed on the effect of the statutory assumption that the hereditament was in a state of repair, and its relationship with the reality principle. The Court of Appeal had considered that the statutory assumption displaced the reality principle whenever the condition of the hereditament was remediable by works which could properly be described as repair.

22. In the Supreme Court Lord Hodge pointed out that the repair assumption had been introduced by the Rating (Valuation) Act 1999 to reinstate the law as it had been understood to be before the decision of the Lands Tribunal in *Benjamin v Anston Properties* [1998] 2 EGLR 147. Before the 1988 Act the statutory hypothesis had been that the landlord was assumed to bear the cost of repairs under the notional tenancy of the hereditament. In a series of decisions of the Court of Appeal this had been held to require an assumption that defects which were present in reality would be put right at the notional landlord's expense, and so would not reduce the rateable value of the subject. In *Benjamin* the Lands Tribunal held that, by placing responsibility for repairs under the hypothetical tenancy on the tenant, the new valuation hypothesis (as originally enacted), did not permit an assumption that the hereditament was in repair if, in reality, it was not. The promoter of the Bill which became the 1999 Act had explained to Parliament that the purpose of the change was to address this conclusion, and to reverse its effect so that "an old principle governing rating valuation should merely be restated" (*Monk*, at [21]).

23. Lord Hodge explained the effect of the assumption that the hereditament was in repair against that legislative background:

> "20. The 1999 Act can thus be seen as applying principles analogous to those in [the cases decided before the 1988 Act] to a hypothetical lease in which the tenant bore the obligation to put the hereditament in repair. In my view the Court of Appeal goes too far in interpreting the 1999 Act as completely displacing the reality principle in relation to both the physical state and the mode of occupation of a hereditament which is undergoing redevelopment. The 1999 Act, by introducing the assumption of reasonable repair at the outset of the hypothetical tenancy ("the repair assumption"), is not addressing the question of whether the premises were capable of beneficial occupation, which, in the context of a building undergoing redevelopment, is a logically prior question. Thus the repair assumption (para 2(1)(b)) applies to matters affecting the physical state of the hereditament (para 2(7)(a)) but not to the mode or category of occupation of the hereditament (para 2(7)(b))."

24. Having identified what the repair assumption was, and was not, intended to achieve Lord Hodge then considered how it was to be applied in practice to a building which was undergoing redevelopment:

> "22. In a helpful intervention, the Rating Surveyors' Association and the British Property Federation submitted that, where works were being carried out on an existing building, the correct approach was to proceed in this order: (i) to determine whether a property is capable of rateable occupation at all and thus whether it is a hereditament, (ii) if the property is a hereditament, to determine the mode or category of occupation and then (iii) to consider whether the property is in a state of reasonable repair for use consistent with that mode or category. The first two stages of that process involve the application of the reality principle. At the third stage the valuation officer applies the statutory assumption in para 2(1)(b) if the reality is otherwise. In my view, this is a helpful approach where a building is undergoing redevelopment."

25. Lord Hodge went on to explain that whether premises were undergoing reconstruction rather than simply being in a state of disrepair must be assessed objectively. Although the subjective intentions of the owner of a property were not relevant, the valuation officer could have regard to the programme of works which was in fact being undertaken on the property. The facts showed that Avalon House had been largely stripped out in the course of a redevelopment and an outline of the future development (the communal lavatory facilities) 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." It followed:

> "… that there is no basis for applying the assumption in para 2(1)(b) to override the reality principle and to create a hypothetical tenancy of the previously existing premises in a reasonable state of repair. This is both because a building under redevelopment, like a building under construction, is incapable of beneficial occupation and, in any event, the hypothetical landlord of a building undergoing redevelopment would normally not consider it economic to restore it to its prior use."

**The valuation officer's submissions**

26. Mr Singh QC submitted on behalf of the VO that the issue in the present appeal was whether, as at 16th January 2013, it was objectively ascertainable that the appeal property was a building under reconstruction. If it was, then applying *Monk*, the statutory repair assumption would not apply, and instead the appeal property would be valued as it stood on that date, at a nominal value. The VO's position was that it was clear that the appeal property was not objectively ascertainable as a building under reconstruction as the material day. Therefore, what Mr Singh called the "building under reconstruction exception" to the repair assumption did not apply.

27. In *Monk*, Mr Singh suggested, there had been two matters from which it could objectively be ascertained that the hereditament was a building under reconstruction. The first was the contract of works, which would have been available at the material day, and which included a programme of works setting out how the hereditament was going to be reconstructed. This programme was not limited to the 'destruction' element of the reconstruction, i.e. the strip out works, but included the 'construction' element, i.e. the creation of the new premises. Secondly, at the material day, the construction element of the works was to some extent physically evident at the hereditament, and so objectively ascertainable: plasterboard partitions to form the proposed communal lavatories and a partition across the east side of the building had been erected, and first fix electrics and drainage to the lavatory area had been installed.

28. Mr Singh submitted that it was only because the hereditament in *Monk* could objectively be seen to be a building under reconstruction that the appellants had succeeded. The same could not be said in the present case. The only documents available at the material day related to the stripping out of the three floors to a bare shell, and that was all that was physically evident on that day. The only constructive, as opposed to destructive, work within the hereditament, namely the addition of the new riser, was irrelevant as it would have been impossible to contemplate the completed hereditament from the presence of the riser. At the material day there was no plan or contemplation of the completed hereditament in existence; that only came into existence when the appeal hereditament was let to the new tenant in 2014.

29. The works of reconstruction in the present case consisted of the strip out works undertaken in 2011 at a cost of around £800,000 and the fit out works carried out in 2014 at a cost of nearly £10 million. Because only the strip out work was objectively ascertainable on the material day, it was, Mr Singh argued, impossible to say that at that date the hereditament was an objectively ascertainable building under reconstruction. Rather, all that was that objectively ascertainable was damage, not reconstruction.

30. Mr Singh referred to the Valuation Office's own Rating Manual (section 3, part 5, disrepair, practice note 1 - Rating (Valuation) Act 1999). This suggests, at paragraph 8.5, that in cases such as *Monk* the first question must always be "is there a programme of redevelopment /reconstruction underway?" The following proposition is then advanced at paragraph 9.8:

> "A programme of reconstruction works may include stripping out what was there before. The work undertaken by the building contractors in both stripping out what was there before and the new work will constitute the programme. However mere stripping out on its own does not of itself constitute or evidence a programme of reconstruction but rather simple damage, putting the hereditament in a state of disrepair."

31. Mr Singh acknowledged that a programme of reconstruction might very well have been the intention of the respondent, and that the VO might have become aware of that intention by making inquiries. But, he suggested, the VO was prevented from paying any regard to the ratepayer's explanation of what was going on because, as Lord Hodge had made clear in *Monk* at paragraph 23, it was impermissible to have regard to the subjective intentions of the property owner when seeking to ascertain whether the hereditament was undergoing reconstruction.

32. Moreover, Mr Singh submitted, a subjective intention on the part of the actual landlord could not be imputed to the hypothetical landlord. The evidence was that there was no single "market norm" and the decision to strip out would depend on the age of the original services and finishes and on the term for which the landlord was seeking to re-let the space. The hypothetical landlord might not insist on a long let and therefore decide not to strip out. Smaller units were more likely to be offered in the minimum, generic condition which might suit smaller tenants (as shown by the respondent's decision to fit out the part of floor 45 that had not been demised to that standard without waiting until a tenant for that part had been found).

33. Finally, Mr Singh submitted, if the VTE had been correct to find that the appeal property in this case was undergoing reconstruction, there would be nothing to prevent a ratepayer from

successfully claiming that a building was under reconstruction after a few items, such as sanitary facilities, had been stripped out at minimal expense thus rendering the building incapable of beneficial occupation.

**Discussion**

34. We do not accept Mr Singh's submissions, as they are plainly contrary to the decision of the Supreme Court in *Monk*.

35. The suggestion that in *Monk* the Supreme Court created "a building under reconstruction exception" to the repair assumption, as Mr Singh submitted and as the VO's Rating Manual implies, is a mistake. As is apparent from paragraph 20 of Lord Hodge's judgment, and from his adoption in paragraph 22 of the sequence of questions suggested by the RSA and the BPF in their intervention, before one comes to consider the effect of the repair assumption in the context of a building undergoing redevelopment, the logically prior question is whether the property is capable of beneficial occupation at all, and thus whether it is a hereditament at all.

36. If premises are not capable of beneficial occupation they are not a hereditament. The only basis on which they may then be included in the rating list is under the convention that allows property temporarily incapable of occupation to remain in the list at a nominal value as a matter of administrative convenience, rather than deleting the entry and creating a new entry when the property once again becomes capable of beneficial occupation.

37. The VO's acceptance in this case that the appeal property is not capable of beneficial occupation is therefore the beginning and end of the appeal.

38. We agree with the submission of Mr Kolinsky QC for the respondent in his skeleton argument, that Lord Hodge did not prescribe that the existence of a detailed programme of works, or physical evidence on the ground of the eventual form of the reconstructed premises, were necessary ingredients before a property in disrepair could be distinguished from a building undergoing reconstruction. The programme of works which is in fact being undertaken is part of the material which can be taken into account in deciding whether, objectively, a building is undergoing reconstruction but it does not follow that the absence of a detailed programme rules out such an assessment. The existence of an outline on the ground of the future development of Avalon House was a feature of *Monk*, but there is nothing in Lord Hodge's judgment to suggest he regarded it as a determinative feature, nor as a necessary condition as a matter of principle. There is also nothing in *Monk* to suggest that the splitting of the hereditament into three units was determinative.

39. In theory at least, the same lack of amenities in a building may have different causes: a vacant building may have no electric wiring or copper plumbing because those building elements have been stolen, or because they have been stripped out to make way for new, enhanced facilities. We return to Lord Hodge's question at paragraph 23 of his judgment. How is a valuation officer to ascertain that premises are undergoing reconstruction rather than simply in a state of disrepair? By assessing the known facts, rather than by shutting his eyes to them. While the subjective intentions of the owner are irrelevant, the objective facts to which those intentions have given rise are not. Regard may obviously be had to a pattern of behaviour in relation to other similar property,

whether, as in this case, by the respondent itself on other floors within the same building, or by the owners of similar high-quality office buildings.

40. Mr Singh's submission that the actions of the respondent itself must be ignored because only the behaviour of a hypothetical landlord can be taken into account is wrong in principle. The question whether a building is incapable of beneficial occupation as a result of a programme of refurbishment is a matter of objective fact featuring no hypothetical characters and requiring no counterfactual assumptions.

41. Even if the behaviour of the respondent itself is irrelevant (which it is not) the VO was well aware, as Mr Dingle explained in his witness statement, that it is common practice in the better office locations in London for landlords to fully refurbish prime office buildings every ten to fifteen years, to maintain the position of the building in the marketplace. Canary Wharf is such a location and behaviour in that sector of the market is objectively ascertainable and may properly be taken into account. Mr Dingle also acknowledged that the respondent's policy of routinely stripping out office floors when its tenants vacate at the end of their leases is consistent with the sector as a whole.

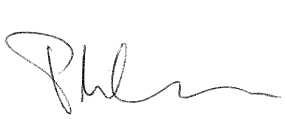
42. We therefore reject Mr Singh's submission that, absent an actual programme of works, it could not be ascertained that the appeal property was undergoing reconstruction. The most cursory investigation by the VO would, and did, readily reveal that refurbishment was inevitable. For this purpose we do not differentiate between basic and bespoke works. To achieve even the basic standard of fit out, office floors in One Canada Square are first stripped back then refurbished in accordance with a recognised programme. The programme of refurbishment in this case may have been open ended, with no contract in place at the start showing how and when the floors would be refurbished, but an informed and objective observer would easily be satisfied that the space would in due course be brought back into a condition in which it would, once again, be capable of beneficial occupation.

43. It is clear that in this case what Mr Singh called "deconstruction works" were not damage, capable of being repaired. The property was stripped back to its shell so that substantial reconstruction and improvement work could be carried out. As the Parliamentary material referred to by Lord Hodge in *Monk* makes clear, in such cases it was the intent of the 1999 Act that the property would be considered in its actual state on the material day and if it is incapable of beneficial use, would be removed from the rating list.

44. Mr Singh confirmed that, had the respondent entered into a contract to refurbish the appeal property before the material day, with work not to take place until some point in the future, perhaps not for two years or more, the VO would treat the appeal property as being under reconstruction. That is an illogical approach, and substitutes a requirement for evidence of a specific type for a proper assessment of all the known facts. The suggestion in the VO's Rating Manual that for premises to be under reconstruction there must be a single programme of works in which stripping out is followed immediately by a reconstruction project is also, in our judgment, mistaken if it is intended to identify an indispensable condition. That is to pick out one relevant feature of what may be a complex factual situation and to make it a positive requirement. That is not a permissible approach.

**Determination**

45. For these reasons the VO's appeal is dismissed. This decision is final on all matters other than costs. If an appropriate order cannot be agreed the parties may make submissions in writing on costs and a letter containing further directions accompanies this decision.



Martin Rodger QC
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Peter McCrea FRICS
Member

7 June 2019