UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

RATING – Valuation – Purpose Built GP Surgeries – Method of Valuation – whether Rentals Basis or Contractor's Basis – tests per* Lotus & Delta v Culverwell (VO) *– rating hypothesis - vacant and to let – value of occupation to occupier - appeal dismissed

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

BETWEEN	**JAMES GALLAGHER (Valuation Officer)**	**Appellant**
	and	
	(1) DR M G READ & PARTNERS (2) DR J POYSER & PARTNERS	**Respondents**

re: Three Purpose Built GP Surgeries in Sheffield

Before: P R Francis FRICS

Sitting at: 43-45 Bedford Square, London WC1B 3AS

on 9 – 12 June 2014

Daniel Kolinsky, instructed by the HMRC Solicitor, for the appellant VO
Christopher Lewsley, instructed under the licensed access scheme by GVA, Commercial Property Consultants, Leeds, for the respondents

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The following cases are referred to in this decision:

Lotus & Delta v Culverwell (VO) [1976] RA 141
Poplar Assessment Committee v Roberts [1922] 2 AC 93
Robinson Brothers (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee [1937] 2 KB 445
R v Paddington Valuation Officer, ex parte Peachey Property Corporation Ltd [1965] RA 177
Orange PCS Ltd v Bradford (VO) [2003] RA 141 (LT); [2004] RA 61 (CA)
Allen (VO) v English Sports Council [2009] RA 289
Hoare (VO) v National Trust (1999) 77 P&CR 366
Lee (VO) v Southwark Manufacturing Ltd (1961) RVR 230
Garton v Hunter [1969] 2 QB 37

DECISION

Introduction

1. These appeals from proposals (which were consolidated by Order of the Tribunal on 31 July 2012) relate to three separate purpose built General Practitioner (GP) surgeries in Sheffield, South Yorkshire following a decision of the Valuation Tribunal for England (VTE) dated 21 May 2012. On the evidence before it the VTE determined that the Rateable Value (RV) of each of the hereditaments should be assessed in accordance with the contractor's basis of valuation as, in its view, there were no truly open market rents that could be relied upon in accordance with the rating hypothesis.

2. The appellant valuation officer (VO) contended that the hereditaments should each be valued using the rental method of valuation, and that the comparables it relied upon before the VTE provided relevant evidence for a valuation on the rating hypothesis as set out in Schedule 6 of the Local Government Finance Act 1988 (LGFA 1988). The RVs determined by the VTE were, therefore, erroneous. The respondent ratepayers contended that the VTE was correct in its determination.

3. The parties agreed that these appeals should be considered to be a "test case" as there were a significant number (approximately 1,600) of other rating appeals on purpose built GP surgeries currently awaiting the outcome of this case.

4. Mr Daniel Kolinsky of Counsel appeared for the appellant VO and called Mr Simon Gomersall BSc (Hons) MRICS a principal valuer with District Valuer Services (DVS) who gave expert evidence relating to the valuation methodology adopted as the basis for assessing Current Market Rent (CMR) within the Doctors' Rent and Rates Reimbursement Scheme (henceforth referred to as the 'DRRS'). The VO, Mr James Gallagher MRICS, a member of the National Specialists Unit within the Valuation Office Agency (VOA), was also called to give valuation evidence.

5. Mr Christopher Lewsley of Counsel appeared for the respondents and called Mr Richard Taylor FRICS MCI Arb, a senior director of GVA Commercial Property Consultants and head of their National Primary Healthcare Team, based in Bristol, who gave expert evidence in respect of the CMR, DRRS and factors relating to the size and viability of purpose built GP surgeries. Mrs Claire Paraskeva BSc (Hons) MRICS, also a senior director within the National Rating Department of GVA based at their Leeds office, gave expert evidence relating to the appropriate methodology to be used in the valuation of this type of hereditament.

The Rating Hypothesis

6. Paragraph 2(1) to Schedule 6 of the LGFA 1988 (as amended) provides:

"(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 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 the usual tenant's rates and taxes and to bear the cost of repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command the rent mentioned above."

The Evidential Hierarchy

7. It was common ground between the parties that in determining the rent at which it is estimated a hereditament might reasonably be expected to be let, the best evidence would be evidence of lettings of comparable premises in the open market. Use of the rentals method would depend, however, on sufficient, appropriate and reliable comparable evidence being available from the marketplace; if it was available it would be top of the evidential hierarchy. The appellant's case was that such evidence is available and he relied on rents payable for other purpose built surgeries as providing it. The respondents' case was that the transactions relied on by the VO did not provide evidence of open market or other rents actively negotiated by a tenant, and provided no reliable guide to the value of occupation to the occupier (see *Poplar Assessment Committee v Roberts* [1922] 2 AC 93). As a matter of valuation judgment, the respondent argued, no significant weight could therefore be given to the rentals method of valuation, and it was necessary to look for a more reliable method and, as such, the contractors basis was the appropriate method.

Issue

8. In substance, therefore, this appeal is about the nature and quality of the evidence relied on by the appellant. The sole issue for determination is therefore whether sufficient reliable evidence has been adduced in this case to enable the appeal hereditaments to be valued on the rentals basis. If not, it was agreed that the contractor's basis should be used, as an argument before the VTE that consideration should be given in the alternative to the receipts and expenditure method was not pursued before me.

9. It was agreed that if the appeal succeeded, and I determined that the appropriate valuation method was the rentals basis, I should direct that the entries in the rating list should be as they existed prior to the VTE decision. On the other hand, the parties also agreed that if the appeal

failed, and I confirmed that the VTE was correct to apply the contractor's basis, the figures assessed by the VTE should be confirmed. Thus, I was not asked to consider and determine a figure based upon specific expert valuation evidence, but simply to determine which the correct approach is. Also, I was not required to consider the matter of the disputed floor areas on Fairlawns.

Facts

10. The parties helpfully produced a statement of agreed facts and issues, from which, together with the evidence and associated documentation, I find the facts set out below. I was also greatly assisted by the compendious closing submissions dated 7 & 11 July 2014 respectively from counsel for the respondents and the appellant VO.

11. The appeals relate to the following hereditaments:

1. **Surgery & Premises, Dovercourt Surgery, 3 Skye Edge Avenue, Sheffield S2 5FX** (Dr M G Read & Partners) **"Dovercourt"**

   A part two and part three-storey purpose built GP Surgery premises extending to 816.9 sq m Gross Internal Area (GIA), 699.01 sq m Net Internal (NIA) constructed pursuant to the grant of conditional planning permission on 1 August 2006 for "Erection of Medical Centre (Use Class D1) incorporating A1 Retail Pharmacy and associated parking accommodation." The premises, which were completed in 2008, are of steel framed construction with brick/block walls beneath pitched, tiled roofs, have an internal fit-out commensurate with the use including an air circulation and ventilation system, suspended ceilings, non-slip floor surfaces and a single lift, together with approximately 50 car parking spaces. The whole is set within steel palisade fencing and is located to the south-east of Sheffield city centre in a predominately residential area. The surgery and pharmacy currently only occupy the ground and first floor, with the second floor (which is not part of the hereditament) being vacant and in shell condition.

   The hereditament is occupied under the terms of a lease between the developer, Matrix Realty, and Dr Read & Partners for a term of 25 years from 12 May 2008, with the tenant being responsible for internal repairs only, at a commencing rental of £113,000 pa subject to 3 yearly rent reviews.

   A proposal under regulation 8(6) of the Non-Domestic Rating (Alteration of Lists and Appeals) (England) Regulations 2009 was made by GVA on 19 December 2011 for the reduction of the rateable value to £1 on the grounds that the alteration made by the VO to the 2005 rating list on 1 August 2008 which entered the rateable value in the list at £70,500, was incorrect, excessive and bad in law. The appeal was transmitted to the VTE on 29 December 2011. The VTE determined the rateable value at £24,000 with effect from 19 May 2008.

2. **General Practice Surgery, Fairlawns, Middlewood Road, Sheffield S6 1TT** (Dr J Poyser & Partners) **"Fairlawns"**

A three storey purpose built healthcare development, completed in 2005 in the predominately residential Middlewood area, to the north-west of Sheffield City Centre. It comprises a GP Surgery, PCT out-patients clinic, a dental out-reach training facility and a pharmacy. The hereditament extends to 683.15 sq m GIA. The parties have been unable to agree the NIA, the appellant VO contending for 634.0 sq m, and the respondent ratepayer for 504.12 sq m. It is of steel framed and brick/block construction under pitched profile metal roofs. Externally there is hard and soft landscaping and approximately 70 parking spaces. There is vacant, shell accommodation on parts of both first and second floors which do not form part of the hereditament.

The appeal hereditament is occupied under the terms of an internal repairing lease between the developer, United Healthcare Developments Ltd and Dr Poyser and Partners for a term of 25 years with 3 yearly upward only rent reviews. The lease relates to the areas occupied by the GP surgery and the PCT occupational area and had a commencing rent of £257,875 pa from 20 June 2005, reviewed to £300,000 pa on 20 June 2008. The Dental facility which occupies part of the second floor is subject to a separate lease from the landlord, and is not part of the appeal hereditament.

Two proposals were made by GVA on 19 December 2011 for the reduction in the rateable value to £1. Firstly, in respect of the alteration to the entry in the Rating List to RV £32,000 with effect from 4 July 2005 made by the DV on 10 October 2005, and secondly to the further alteration made on 21 June 2007 which increased the rateable value to £49,750 with effect from 21 June 2007. The reasons for the proposals were the same as given in "Dovercourt" above. The VTE determined the rateable value at £19,250 with effect from 4 July 2005 (and 21 June 2007).

3. **Surgery & Premises, Tramways Medical Centre, 54A Holme Lane, Sheffield S6 4JQ** (Dr J Poyser & Partners). **"Tramways"**

A purpose built two-storey property completed in 1993 and located in Hillsborough to the north-west of Sheffield city centre. The building and site are divided into two halves with the appeal hereditament occupied by Dr Poyser & Partners, who own the freehold. The other half is owned and occupied by another practice, Dr O'Connell & Partners. The appeal hereditament is agreed to have a GIA of 431.2 sq m and an NIA of 365.89 sq m. It is of conventional brick and block construction under tiled roofs and there is very limited external parking for 18 cars.

A proposal was made by GVA on 19 December 2011 for a reduction in the rateable value to £1 from the entry in the 2005 Rating List of RV £28,500. The VTE determined the rateable value at £11,500 with effect from 1 April 2005.

The VTE Decision

12. In its decision of 21 May 2012, the VTE noted (in paragraph 10) that both Dovercourt and Fairlawns were rented, but that the respondent VO had not sought to rely upon the passing rents to inform his opinion of rateable value, nor did he rely upon the other rents paid at Fairlawns by the PCT and a dental surgery. The VO instead relied upon a schedule of 13 rents on other purpose built surgeries, and the VTE said that whilst it did not believe the appellants disputed their comparable nature subject to any adjustments required in respect of Tramways to reflect its access and parking difficulties, there was considerable disagreement regarding the use of these rents. As all the rents were derived on the same basis, and the vast majority were on 25 year terms with three-yearly rent reviews, the VTE went on to consider these comparables, and particularly the letting to Owlthorpe Medical Centre which was, it was said, on the face of it good evidence. It considered also the professional opinion of the appellant ratepayers' expert witness, Mr Cooney, who stated that the leases of this type of property were for longer terms than is the norm for standard commercial premises such as offices, and also that five yearly rather than three yearly reviews were typical. Having said that it was not persuaded by that evidence that the comparables were anything other than the norm for this type of property, the VTE went on to say:

> "14 However, both parties accept that these rents are not based upon the open market, but are in fact based upon independent valuations undertaken by District Valuer Services (DVS). The methodology of reaching this value, referred to as the current market rent (CMR), is set out in two documents, initially the Statement of Fees and Allowances payable to General Medical Practitioners in England and Wales (1996 Edition) which was superseded by the National Health Service (General Medical Services – Premises Costs) (England) Directions 2004. They are as follows:
>
> Statement of Fees and Allowances (Para 51 Schedule 4)
>
> Definition
>
> The current market rent (CMR) is the rent which the District Valuer (DV) considers might reasonably be expected to be paid for the premises concerned at the valuation date. The basis used by the DV for assessing the CMR may be different from owner-occupied premises (see paragraph 2(b) below). In both cases the aim will be to arrive at a rent which can be agreed between the practitioner (or his or her representative) and the DV in willing negotiation with neither party seeking to take advantage of, on the one hand, the fact that the practitioner's remuneration is so arranged that his rent and any VAT properly payable is separately reimbursed and, on the other, that at any one time only one practitioner (or one practice) is permitted to be in the market to use the premises for practice purposes.
>
> The National Health Service (General Medical Services – Premises Costs((England) Directions 2004 (Schedule 2)
>
> Factors Common to All Current Market Rent Calculations

Current market rent calculations for notional rent purposes differ from current market rent calculations for actual leasehold premises pursuant to direction 33.

However, in both cases, the valuer must consider what might reasonably be expected to be paid by a tenant for the premises at the valuation date. The aim will be to arrive at a rent which can be agreed between the contractor (or his or her representative) and a third party in a willing negotiation. For these purposes, it must be assumed that neither party is seeking to take advantage of the fact that –

a) The contractor's remuneration is so arranged that his rent and any VAT payable is reimbursed separately; and

b) At any one time only one contractor is permitted to be in the market to use the premises for practice purposes."

13. The VTE went on to consider the evidence and arguments of Mr Gomersall (for the respondent VO) and Mr Cooney for the appellants, and noted that whilst the DVS also determines CMRs on owner occupied surgeries and medical centres, Mr Gomersall was not relying upon those valuations in his evidence as they are not rents and continued, at paragraph 16:

"….I must add that I am not unhappy to disregard these CMRs. It was a point accepted by both parties that, as the CMR is fully reimbursed to the GPs, there is no incentive to seek a reduction in the CMR."

17. The CMRs I must focus on are those where third parties are involved…"

14. At paragraph 21, the VTE said:

"… both parties accept that the CMR and indeed the lease are not based upon tenants' bids on vacant premises described by the appellants as 'open market rents' but are based upon leases formed by CMRs. It is unfortunate that Mr Gallagher was not able to advise me as to the CMRs initially determined for all the rented comparables in his schedule. He did, however, concede that the lease rents would be based upon the CMRs, but adjusted to reflect full repairing and insuring terms (FRI) and any areas such as additional office space that were not part of the reimbursement scheme."

15. The VTE then considered whether the lease rents created by the CMRs are sufficiently close to the definition of rateable value contained within Schedule 6 of the Local Government Finance Act 1988 (LGFA 1988) and in paragraph 23 of its deliberations also took into account counsel for the appellants reference to *Lotus & Delta Ltd v Culverwell (VO) & Leicester City Council* [1976] RA 141 which records, at page 150, Lord Denning MR in *R v Paddington Valuation Officer, ex parte Peachey Property Corporation Ltd* [1965] RA 177, 198 as saying:

"But counsel for the ratepayers also said that the valuation officer failed to take into account the vital consideration: What would a hypothetical tenant pay for the particular hereditament? I do not think that counsel made that point good. He established, I think,

that the valuation officer in many cases ignores the *actual rent* of the dwelling. But that is no ground for invalidating the whole list. The rent prescribed by the statute is a *hypothetical rent*, as hypothetical as the tenant. It is the rent which an imaginary tenant might reasonably be expected to pay to an imaginary landlord for a tenancy of *this* dwelling in *this* locality, on the hypothesis that both are reasonable people, the landlord not being extortionate, the tenant not being under pressure, the dwelling being vacant and to let, not subject to any control, the landlord agreeing to do the repairs and pay the insurance, the tenant agreeing to pay the rates, the period not too short yet not too long, simply from year to year. I do not suppose that throughout the length and breadth of Paddington you could find a rent corresponding to this imaginary rent. Take hereditament after hereditament; go through the rental returns; you will find in case after case that the actual rent is no useful guide. It may be controlled or transitional; it may be ground rent or a concessionary rent; or it may be paid by an immigrant under pressure; or the like. The rent is only of use when it is a rent freely fixed in the market without a premium or any special conditions. And even then you may find variations from one house to the next, from one flat to the next, so great that you cannot say from the actual rent what is the rent which may reasonably be expected. But nevertheless an expert valuer may by analysis of rental returns and by looking at comparable cases be able to form an opinion as to what rent may be reasonably expected. That is what the valuation officer says he did here."

The VTE continued, at paragraph 24:

"24. The rent that I am trying to determine is the one that the hypothetical tenant might pay to the hypothetical landlord with the hereditament vacant and to let. The appellants considered that, as these hereditaments were never vacant and to let and were arranged with full funding of the rent already in place, the rents determined under CMRs could never meet the statutory definition. I do not believe this to be the case. Whilst the CMR is reimbursed fully I do not believe this automatically disqualifies consideration of this figure. Counsel for the respondents referred to the decision in *Sport England v Allen* [2009] RA 289 [actually *Allen (VO) v English Sports Council* [2009] RA 289] to reinforce the view that real world funding should not be disregarded.

25. However, what I do need to ensure is that the rent determined by DVS for a CMR is the same as that which could be freely fixed in the (open) market. It may be that there is only one potential tenant for each surgery, but what I do need to be sure of is that the rent achieved is one that could be freely negotiated. The tenant will invariably be looking to secure the premises at a low rent, whereas the landlord will be looking for the best return possible. This is commonly described as the "higgling of the market". Frequently, as indeed pointed out by Lord Denning, there might well be great variations in rents in any area, but somewhere within what is frequently called 'the basket of rents' is the reasonable rent.

26. The difficulty I have is that there are no open market rents to test this against as accepted by both parties…"

16. Setting out the reasons why it cannot be stated with any great certainty that the CMR meets the definition of rateable value, the VTE said in conclusion:

"30. … I cannot say with any certainty that the leases created result in an amount that the property might reasonably be expected to let from year to year in accordance with the definition of rateable value. The leases which are derived from CMRs produce an agreed rent between practitioner and DVS. This is not necessarily the same thing and without checks provided by open market rents to confirm this I am not satisfied, for the reasons given above, that they do."

17. The VTE then went on to consider the arguments relating to whether or not the R&E method was the correct one to use if the rentals method was not deemed appropriate, and concluded that the contractor's basis was the right approach. As this issue is not before me, I need say nothing further about it, but for the sake of completeness, I set out the VTE's final paragraph:

"36. Finally, there is one matter which concerned the respondent [VO] and [about] which I also have some reservations. The figure produced by the contractor's basis for purpose built surgeries and medical-centres is low compared to those older practices where open market evidence is available. Whilst this does leave me uncomfortable when looking at the valuations of these types of premises as a whole it is due to the lower decapitalisation rate set by the Secretary of State rather than any failing in the valuation. The Secretary of State must have good reason for doing this which is outside of my determination and it would be wrong of me to take it into consideration."

Guidance referred to in evidence

18. The RICS Guidance Note: GN 10 – Valuation of Surgery Premises used for Medical Health Services (effective 1 July 2003), provides, where relevant:

"**GN 10-1 Application and scope of this Guidance Note**

This Guidance Note, which supplements the Practice Statements and Guidance Note 1 in this manual, applies to the valuation of surgery premises, including all medical centres and surgeries occupied by dentists, doctors and other similar practitioners for medical or health services. It does not apply to properties owned by or leased to the Secretary of State or NHS Trusts (except to the extent that they are leased to GPs), or to valuations carried out under statutory provisions, or to private healthcare properties such as nursing or residential care homes. However, some of the considerations covered may be relevant to such properties.

GN 10.2 The Impact of the National Health Service

GN 10.2.10

For premises accepted by the HA [Health Authority] as providing GMS [General Medical Services], the basis for reimbursement within the SFA [Statement of Fees and Allowances] is the CMR. It is defined in SFA Paragraph 51 Schedule 4, which distinguishes owner occupied and rented premises. For owner occupied premises a notional lease with defined terms is assumed, whereas for rented premises the terms of the

lease are generally adopted. However in all cases the CMR is based on the landlord being responsible for external repairs and insurances (See GN 10.5.5).

GN 10.2.12

The HA may be prepared to offer an alternative basis of reimbursement, known as the Cost Rent, where new premises or substantial modifications are involved. This is subject to a number of variations, but in essence is intended to reimburse the expected cost of financing the interest payments on an assumed loan necessary to acquire the site and build the surgery…

GN 10.5 Valuation Considerations, Evidence and its Application

GN 10.5.4

Cost Rents are inappropriate for comparison purposes, since these are payments entirely unrelated to rental value, being calculated by a formula method based on building costs, site value and interest rates…

GN 10.5.5

CMR is assessed on behalf of the HA by the District Valuer and assumes that the premises are held on a lease under terms specified in the SFA which, for example, require the landlord to bear liability for external repairs and the cost of insurance. Thus, in order to make a comparison with market rents, adjustments are necessary. Where the Valuer is satisfied with the accuracy of the CMR, it is considered to be relevant evidence and due weight should be given to it in assessing value, to the extent that it would be reflected in the market."

The case for the appellant

19. In its statement of case, the appellant VO said that the VTE was mistaken in its approach, and that the existence of the DRRS does not render nugatory the body of real world rental evidence which is available to the valuer. There is, it was argued, a market for purpose built GP surgeries which are bespoke premises built to exacting standards, and which over recent years have been replacing the more traditional doctors' accommodation typically situated in converted premises. It is a market in which transactions take place, and there is ample real world evidence of transactions relating to similar properties at and around the AVD (1 April 2003).

20. The DRRS is a form of public subsidy for doctors' surgeries and, as the VTE acknowledged at paragraph 24 of its decision, that subsidy should not be disregarded in the rating hypothesis. That real-world subsidy/funding can reasonably be assumed in the rating hypothesis was confirmed by the Lands Tribunal in *Allen (VO) v English Sports Council* [2009] RA 289, and there was no relevant conceptual difference if the subsidy in question took the form of a reimbursement of rent and rates as distinct from a capital subsidy. Thus a valuer can, and should, stay in touch with the actual market as much as the hypothesis allows. It was pointed out further, in response to the respondents' statement of case in reply, that it needed to

be borne in mind that within the DRRS (at paragraph 51 and Schedule 4 of the Schedule of Fees and Allowances) the fact that the rent is reimbursed is to be expressly disregarded ("neither party seeking to take advantage of … the fact that this rent and any VAT properly payable is separately reimbursed").

21. The VTE appeared to have asked itself the wrong question in deciding that it needed to ensure that the rent determined by the DVS for a CMR is "the same as that which would be freely fixed in the (open) market." That approach seemed to overlook the actual availability of real world market evidence – namely rents that have been agreed between tenants and landlords, albeit that those agreements were made in a market in which the DRRS exists as a means of providing a public subsidy towards the GPs' occupational costs. It also ignored the ability for a rating valuer to make adjustments to the available rental evidence for any inflationary effects of the real world subsidy which could not be assumed to exist in the rating hypothesis, although the need for any such adjustment was denied. It was wrong to search for paradigm evidence of open-market transactions when the only relevant market was one in which the DRRS scheme existed.

22. It was therefore the VO's primary case that the RV for the hereditaments can readily be derived from the available comparable rental evidence, and that similar subsidy arrangements should be assumed to exist in the rating hypothesis. To the extent that it is necessary to make any comparisons between the CMR under the DRRS and the statutory hypothesis, it was argued that DVS act as independent and impartial adjudicators and their role is to ensure that the CMR which is set under the scheme is a realistic assessment of the market value subject to the prescribed assumptions of the DRRS scheme. Whilst closely comparable to each other, any differences between the CMR process and the statutory hypothesis can be dealt with by making necessary adjustments. Accordingly the VTE was wrong to conclude that the hereditaments could not be valued by the rental method of valuation.

23. Whilst the VO's valuations under the rental method amounted to RV £87,250 for Dovercourt, £79,250 for Fairlawns and £28,500 for Tramways, it was contended that the pre-VTE decision rating list entries should be restored to RV £70,500 for Dovercourt with effect from 19 May 2008, £23,000 for Fairlawns with effect from 4 July 2005 increasing to £49,750 with effect from 21 June 2007 and RV £28,500 for Tramways from 1 April 2005.

24. Expanding upon the statement of case in his opening skeleton, Mr Kolinsky said that in the approach to rental evidence, which was at the top of the evidential hierarchy in terms of weight (per *Lotus & Delta v Culverwell (VO)* [1976] RA 141 at 153), it was the duty of the valuer to "take into account every intrinsic quality and every intrinsic circumstance which tends to push the rateable value up or down, just because it is relevant to the valuation and ought therefore to be cast into the scales of balance" (per Scott LJ in *Robinson Brothers (Brewers) Ltd v Houghton and Chester-le-Street Assessment /Committee* [1937] 2 KB 445 at 469. That premise was also expressly confirmed in *Garton v Hunter* [1969] 2 QB 37 where Lord Denning MR said, at 44:

"We admit all relevant evidence. The goodness or badness of it goes only to weight, not to admissibility."

25. And, further based upon the dicta from *R v Paddington Valuation Officer, ex parte Peachey Property Corporation Ltd* [1965] RA 177 cited in *Lotus* and set out by the VTE (see paragraph 15 above), together with the guidance in *Lotus,* the basket of available rents should be analysed as part of the valuation process.

26. Referring to *Hoare (VO) v National Trust* (1999) 77 P&CR 366, *Poplar v Roberts* [1922] 2 AC 93 and *Orange PCS Ltd v Bradford* [2004] RA 61 (CA), Mr Kolinsky said that where the relevant real-world conditions do not conflict with the rating hypothesis, the principle of reality supports taking account of them in ascertaining the rental value. It was important, as Mr Gallagher had said, for the valuer to stay in touch with the market as far as the rating hypothesis allows.

27. Mr Kolinsky said that it was important for this Tribunal to appreciate the VTE's error in redefining the requirements for relevant rental evidence, thus ignoring the pool of real world transactional evidence, such as the rents paid by health care providers who do not receive subsidy which were at substantially the same levels as those who do benefit from the DRRS scheme. Examples include doctors paying for additional space (outside the scheme), premises occupied by PCT's (for example at Fairlawns) and premises occupied by dentists (again outside the scheme). Whilst it was accepted that that evidence post-dated the AVD, it is relevant and admissible to support the proposition that there is no material disparity between the rents paid both within and without the scheme by tenants enjoying the same mode and category of occupation. That evidence, it was submitted, provides the very reality check that the respondents wrongly assert as lacking. Mr Kolinsky pointed out the fact that the parties had agreed that "it is acknowledged by both parties that PCTs and GP practices pay the same or a very similar level of rent per square metre in respect of the accommodation they occupy when holding leases containing similar terms and conditions" (see statement of agreed facts an issues, section H). That was an important point, he said, that might save the Tribunal time in its deliberations.

The evidence

28. **Mr Gomersall** has been a chartered Surveyor for 28 years working initially in the Valuation Office Agency (VOA), and in 1991 joined the District Valuer (DV) section, specialising in advising NHS clients. In 2000 he became the main lead for Primary Care Development (PCD) in North London before, in 2003, becoming a Principal Valuer specialising further in PCD and reimbursement under the approved NHS scheme**.** No longer involved in rating matters as such, Mr Gomersall said his principal role involves advising NHS bodies regarding value for money development projects, agreeing CMRs and advising and mentoring a national team of valuers.

29. The purpose of his expert witness report and rebuttal statement was to set out the basis of assessment for CMRs within the DRRS, to explain the role of the DV in the process and to describe the valuation methodology used.

30. Mr Gomersall explained that the DRRS commenced on 1 April 1966 when purpose built doctors' surgeries of the type the subject of this appeal were uncommon. One of the aims of the scheme was to promote better quality healthcare premises by way of reimbursing GPs their rent and rates. An important safeguard built into the scheme was that the amount reimbursed in respect of rented premises will never exceed the adopted CMR. The DV's role in assessing the CMR on leasehold and owner occupied premises, as set out in Para 51, Schedule 4 of the SFA, is to be totally impartial and to "stand independent of both parties". He must be neutral, objective and unbiased.

31. The SFA sets out the different assumptions to be applied in respect of leased and owner occupied premises. In leased premises, the DV will, under Paragraph 51, Schedule 4, 2 (ii), have regard to the lease terms, and paragraph 51.20 of the SFA (now NHS Direction 2004, section 32) states that the amount which a Health Authority (HA) must pay in respect of the GPs rental costs *"will be the lease rent or the assessment of current market rent by the District Valuer, whichever is the less."* The figure that the DV comes to will be subject to any necessary adjustments, principally the fact that it is to be assumed that the landlord bears the liability for external repairs and the costs of insurance. Whilst the actual rent payable by the GP practitioner tenant to the landlord at inception and review is ultimately a matter to be agreed between them, the DV's role is solely to provide a CMR assessment. In connection with owner-occupied premises, the DV will have regard to the notional lease terms as set out in Paragraph 51, Schedule 4, 2(i) which assume a lease of 15 years with three yearly upward only rent reviews, landlord responsible for external repairs and insurance and that, on the initial assessment at inception, the premises are vacant and to let.

32. Schedule 4 of the SFA states that the CMR is to be assessed *"in willing negotiation"* as between a willing landlord and a willing tenant. The fact that the GPs are to be reimbursed their rent and rates liabilities is to be ignored in the assessment of CMR, and there is therefore no justification in assuming that the GP practitioner might be prepared to agree a rent at any price. If the agreed lease rent exceeds the CMR, then it is the lower figure that is reimbursed, and the GP practitioners would therefore have to make up the difference out of their own pockets. There is therefore an incentive for the GP to negotiate with the landlord in order to arrive at a figure which would be the result of negotiations between a willing lessee and a willing lessor. The assessment is also to ignore the fact that under the rules, no more than one GP practice can be assumed to be in the market at any one time.

33. As to the respondents' suggestion that, in respect of new developments, the initial rents are based upon appraisals and therefore linked to the cost of development, Mr Gomersall said that the DV has to consider a development appraisal under Paragraph 51.3 (iv) of the SFA (now in NHS Directions, section 10) which require the PCT (now NHS England) to be satisfied that the proposed development represents value for money. But, appraisals are not valuations, and CMRs are not appraisal led. There is no provision for an appraisal led approach to assessing

CMRs within either the SFA or the NHS Directions, and the appraisal is simply a tool to establish whether or not the proposed development will be economically viable. In reality, some schemes do not proceed because the CMR assessment is lower than the anticipated rental figure entered into the appraisal. If they were the same, all schemes would proceed and, he said, that is not the case. It should be borne in mind that the DV does not negotiate and agree the actual rent which will be payable under the lease. There is thus nothing preventing a GP and a landlord from agreeing an actual rent that is different from the CMR.

34. In setting the CMR, which is an opinion of value rather than a transaction, the DV will have regard to the evidence available which will include market evidence of comparable lettings within the same use class, the evidence of other CMRs and other market evidence from premises within different uses. Market rental evidence from lettings of directly comparable properties which are not within the DRRS, such as PCTs, dentists and other health users would normally be expected to carry more weight than other CMR agreements, but nevertheless CMRs do provide an acceptable source, especially where those CMRs are agreed with professional agents, and should thus be included within the 'basket of evidence'. Whilst the DV may be aware of and take into consideration the actual rent passing on a property, they make no presumption that this sets the CMR. It is not the case that just because the lease terms accord with the valuation assumptions that the DV is obliged to adopt, the CMR will be set at the same level as the actual rent.

35. With the role of the DV being to act independently and impartially in exercising his skilled professional judgement, Mr Gomersall said that evidence from other CMRs can be considered to be good and reliable support for the conclusions that he draws. The scheme has been in existence for some 47 years and, he said, that alone speaks for its robustness.

36. Whilst admitting that he was not a rating expert, and that Mr Gallagher was better placed to discuss the approach to valuation in rating, he said that it was his understanding that the definition of rateable value is not dissimilar to that of a CMR; thus a competent and experienced valuer would have little difficulty in adjusting a CMR to accord with the definition of rateable value.

37. Mr Gomersall also said that Mr Taylor's evidence failed to appreciate the important distinction between the two distinctly separate roles that the DV undertakes in respect of CMR assessments and Value For Money (VFM) reports. He set out the historical background to the two roles which demonstrate that the value for money considerations were introduced as an additional element of the overall DRRS, and that they did not alter the fundamental tenet of the basis of calculating CMRs. He also said that Mrs Paraskeva's references to costs and appraisals were for the purpose of considering the value for money aspects and it certainly does not follow that CMR rents are based upon cost, or result from an appraisal led approach.

38. Typically, the DV's report on VFM provided to the HA/PCT would highlight factors such as build cost, pharmacy rents or premiums, prevailing land values and other matters that have an impact on whether the scheme is potentially viable, and thus provide value for money. Where

the actual lease rent required by a landlord to make a scheme viable is lower than the separately assessed CMR, it is specified in paragraph 51.20 of the SFA that the payment (reimbursement) in respect of rented premises will be the lease rent or the CMR whichever is lower.

39. Mr Gomersall also mentioned Mr Taylor's references to cost rents, which were an alternative and purely formulaic method of calculating reimbursement available to GPs, based upon such matters as building cost and site value. Cost rents calculations are entirely separate from, and do not influence CMRs, and it follows therefore that evidence of cost rents does not form any part of the rental evidence used in the assessment of CMRs. In examination in chief, Mr Gomersall said that the cost rent option had not been adopted in any of the last 75 GP premises valuations that he had been involved with, all having been based on CMRs.

40. In cross-examination, Mr Gomersall insisted that the initial rent was not normally appraisal led. Advised that Mr Gallagher said he considers lease rents when preparing his rating valuation, he said the only time that a lease rent could be described as appraisal led is when it is below the level of the CMR. The DV looks at both the lease rent and the CMR to establish the level of reimbursement – that reimbursement being based upon the lower amount to prevent the GP benefitting from a potential profit rent. Asked at what stage the DV assesses the CMR, Mr Gomersall said that the DV's initial opinion of an anticipated CMR will be provided to the PCT/HA for input into the viability assessment. The CMR normally mirrors the lease rent which will be inserted into the pre-let agreement which is a feature of most new developments. The amount of the rent to be inserted in the pre-let agreement will be tested for robustness in the appraisal process in determining whether or not the scheme will proceed. It was accepted by Mr Gomersall that the valuer will, therefore, have regard to the initial lease rent in determining the CMR in circumstances where that initial rent is known. Where it is not, or it has not been agreed, it was acknowledged that the proposed CMR will inform the lease rent. If the disparity is too high, this will obviously affect the prospective viability of the scheme. There have been occasions where the initial lease rent agreed has been higher than the adopted CMR, Mr Gomersall said.

41. It was common ground that, in assessing the CMR, accepted practice is to add 5% to the rent to reflect the fact that the tenant will only be responsible for internal repairs and redecorations, with the landlord having liability for external repairs and insurance. In the schedule of comparables produced by Mr Gallagher [bundle 3 p 442] it was agreed that the lease rents were fixed by deducting 5% from the CMR.

42. Mr Gomersall was referred by Mr Lewsley to the final inspection report of the DV to the PCT dated 22 July 2008 relating the Dovercourt surgery development. This followed his interim report dated 2 May 2007. In his final report he said, under the heading OPINIONS OF VALUE:

> "1. I am of the opinion that the market rental value under the actual lease which represents Value For Money to the NHS is the sum of £113,000 including VAT. This figure reflects 50 car parking spaces. I understand that you require this VFM rent to be included by the parties in the Lease and that the parties have concurred.

2. Having regard to the NHS Directions, this actual rent for purposes of establishing CMR under the DRR Scheme

(i) does not require adjustment

I am of the opinion that for the purposes of the CMR under the DRR Scheme, the actual rent shown at (2) *(sic)* above may be accepted."

Mr Gomersall said that where one agrees upon a pre-let, one expects the CMR to be set at a level that is considered to be appropriate on the date of completion of the development. Although he had said at paragraph 6.5 of his report that the DV does not negotiate and agree the actual lease rent – that being a matter for agreement between the GP tenant and the landlord, he accepted that in practice the DV does negotiate the Value For Money rent that should be inserted in the lease. In a case where the CMR is higher than the lease rent, it was accepted that the CMR could be said to be appraisal driven. Where the CMR is the same as the lease rent, the CMR is derived from the basket of comparable rents. However, he agreed that the rents were not open market transactions and that the rent agreed between the DV and the GP was not an arms length negotiation between landlord and tenant. This was, he accepted, a specialist market, and he agreed that the basket of rents include notional rents on owner occupied properties and other CMRs.

43. **Mr Gallagher** is a chartered surveyor and has been employed by the VO for 30 years dealing mainly with rating matters. In 2011 he joined the National Specialists Unit dealing principally with civic properties. He said he had not been closely involved with the settlement of rating appeals in respect of GP surgeries and health centres in the 2005 rating list until he assumed responsibility for these appeals at the VTE stage.

44. He said that in his opinion, the existence of actual rental evidence within the same mode and category of occupation meant that the rentals approach should be the primary method of valuation, following the generally accepted hierarchy of evidence as set out in *Lotus & Delta*. His understanding was that there is no requirement to assume an open market if the actual market into which the premises fall is limited by regulation or circumstance. It was necessary to stay in touch with reality as far as the rating hypothesis allows.

45. Whilst the two appeal hereditaments that were let had their rents fixed some time after the AVD of 1 April 2003, Mr Gallagher said there are a number of comparable surgeries that were let around the AVD. The rents are not hypothetical rents, but actual rents that had been agreed in this particular market. Taken as a whole, it was his opinion that they form a good body of reliable evidence which is capable of analysis and from which sound conclusions can be drawn. In addition, there was evidence from CMRs. He accepted that a CMR is not an actual rent, but a valuation undertaken by a DV for the purposes of calculating reimbursement under the DRRS, and said that where both actual rents and CMRs are present, the actual rent forms the better evidence of value. With owner occupied premises, such as Tramways, a CMR valuation undertaken close to the AVD was a useful addition, he said, to the basket of evidence referred to.

46. Mr Gallagher said that in weighing up whether the available rental evidence (as set out in a Schedule he produced at bundle 3 p.442-445) was sufficiently robust to form the preferred basis of valuation for the appeal hereditaments, he asked himself a number of questions. Firstly, whether the rented properties in the list were comparable. He said that in terms of age, size and location they were, and they were also in the same mode and category of occupation. However, it was his understanding that the original 2005 rateable values valuations provided by the VO were based upon a less specific basket of evidence. They were derived from schemes of valuation used for offices, and he acknowledged that it "would normally be wrong to transpose values from one mode and category of occupation to another." The high specification required for the new GP surgery developments was very different from offices, and so were the locations and type of occupier.

47. Secondly, were the lease terms capable of analysis? He considered that they were; the only adjustments required being where the rents were not on full repairing and insuring terms. That was made at 5%, and the use of that figure, to reflect those differences, was common ground between the parties if it were to be found that the rentals basis was the correct method. Thirdly, were the rents determined between connected parties? The answer was no. The landlords, who are usually specialists in the provision of such developments normally hold them as long term investments and can thus be described as separate, self interested third parties. Fourthly, were the rents tainted by the DRRS? This was undoubtedly the case, as it influenced the market for the development of more modern, high specification, specialist facilities. Without such a scheme, there were doubts over whether any of them would ever have been built. However, he said he did not disregard the existence of the DRRS as it was his understanding that the position was as set out by Scott LJ in *Robinson Brothers (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee* [1937 2 KB 445, at 469:

> " In weighing up the evidence bearing upon value, it is the duty of the valuer to take into account every intrinsic quality and every intrinsic circumstance which tends to push the rental value either up or down, just because it is relevant to the valuation and ought therefore to be cast into the scales of the balance before he looks to see the resultant figure on the dial at which the pointer finally rests."

Similarly, Gibson LJ said, in *Hoare (VO) v National Trust* (1999) 77 P&CR 366 at 387:

> "In particular I would emphasise the necessity to adhere to reality subject only to giving full effect to the statutory hypothesis, so that the hypothetical lessor and lessee act as a prudent lessor and lessee. I would call this the principle of reality…"

This puts the hypothetical tenant in a similar position to the GP Practices who have agreed the actual rents set out in the schedule, and who are also reimbursed by the DRRS. Thus, he said he could find no logical reason to ignore or further adjust the evidence due to the existence of the DRRS. Further, Mr Gallagher went on to say that the principle of accepting the existence of real world grants or funding was consistent with the Lands Tribunal's approach in *Allen (VO) v English Sports Council* [2009] RA 289 at paragraphs 55-62.

48. He said that he had also looked at market rents paid by occupiers such as PCTs and dentists' practices which were in the same mode or category of occupation, but where no

reimbursement scheme exists and, importantly, this revealed rents to be broadly at the same level as those paid by practices that were subject to the DRRS. However, he accepted that most developments in this field took place after the AVD, so he had not sought to attach much weight to that strand of evidence, other than to support his overall conclusion that the existence of the DRRS has not resulted in any measurable distortions. Interestingly, he said, one of the PCT rents at Fairlawns showed very little difference per sq m. (£143.18 and £143.10 psm).

49. Asking himself if the existence of an "open market" was imperative to the exercise, Mr Gallagher concluded that whilst it was not open in that no speculative market exists, there is an actual market and it was his view that he was able to form an opinion of rental values from the evidence which exists within that market. To step away from reality and impose an obstacle of only considering rents agreed in a true open market situation was, he said, at odds with his understanding of the rating hypothesis.

50. Mr Gallagher went on to say that he had, in addition to considering lease rents, taken into account evidence derived from one CMR – that relating to Tramways where it was set in 2002, close to the AVD. He accepted that CMR valuations were expressions of opinion and were not from actual transactions. However the parameters under which CMR valuations are undertaken are that it should be assumed there is a willing negotiation, and the fact that the rent is to be reimbursed must be ignored, as should the requirement to disregard the fact that there is only one tenant in the market. DVs have been undertaking such valuations for over 40 years and are a recognised source of expertise on Value For Money and valuation matters for PMCC premises – see RICS Valuation of Medical Centre and Surgery Premises Guidance Note 60/2010. Although CMRs did not form the mainstay of his evidence, he said they were relevant in informing rental levels in the real world. There is under normal circumstances, he said, a clear and understandable relationship between the level of CMR and the level of rent.

51. In respect of Mrs Paraskeva's evidence, Mr Gallagher said he could not agree with her dismissal of the lease rent evidence on premises that were subject to the DRRS on the grounds that the landlord is seeking a rent that reflects returns on the cost of development. In the real world, that is no different from the approach that any developer would take where it is intended to hold developments for the purposes of investment.

52. Mr Gallagher said that, in the present rating list there were some 23,000 doctor's premises that had been assessed on a rentals basis, and 2,000 that had been assessed on the contractor's basis. In the 2005 rating list, there were 300 outstanding appeals on the contractor's basis, and 1,300 where the assessments were based upon the rentals basis.

53. In cross-examination, Mr Gallagher said that whilst he had not dealt with this matter at the time of compilation of the 2005 list, he had taken it on because it was decided that it "needed a fresh look." Instructions to VOs in connection with assessments under that list had been to use the rentals basis for doctors' surgeries, and the contractor's basis for PCT properties if there was no sufficient rentals evidence available. He accepted that the rentals valuations produced by VOs for the 2005 list were based upon different mode and category of occupation

(secondary offices) than was being used in his valuations. He said he was approaching this exercise with a fresh pair of eyes, and he had adopted a procedure which he considered to be the most apposite i.e., by comparing with properties that are in the same mode and category of occupation. He admitted that he did not know whether his approach was the first time that it had been used.

54. In terms of the rating hypothesis, Mr Gallagher accepted that it assumed there was a hereditament, but that in respect of Dovercourt and Fairlawns that was not the case at the AVD of 1 April 2003 as they had not by then been built. They were all, obviously, in existence at the material day, but the relevance of the AVD was that that was the valuation date for the purposes of assessment. He also agreed that it was to be assumed that the premises were on the market, vacant and to let and that the negotiation for rent was to be agreed between a hypothetical landlord and a hypothetical tenant. Whilst he accepted that in this case it was not an open market, but a specialist development market which related to pre-lets, he insisted that whilst the market was informed by the existence of the DRRS, that did not mean reliance upon it should be overridden. The market was a reality and he believed that the hypothesis allowed him to take it into account. He also accepted that the objective of rating valuation was to assess the value of occupation to the occupier, and that where a tenant signs a lease knowing that the rent is to be reimbursed, that might not be a reliable indication of the value of the occupation to him. He agreed that the fact of reimbursement removed any real incentive for the tenant to try to negotiate the lowest possible rent – that being contrary to the willing negotiation principle. There was no reason, however, to suspect that the hypothetical tenant would expect to pay a rent that was any different.

55. With the DRRS scheme having been in existence since 1966, Mr Gallagher accepted that it could be argued that the DVs assessments for the CMR were opinion based upon opinion, but nevertheless he did have the PCT non-reimbursable rents to help him form that opinion.

56. In re-examination, Mr Gallagher agreed that, although he accepted that the hypothetical tenant who had his rent reimbursed was less inclined to argue for the lowest rent he could obtain (which he undoubtedly would if the money was not being reimbursed), the PCT that would be responsible for the payment whilst not the hypothetical tenant under the hypothesis, would have to ensure that the Value For Money requirement was achieved.

The case for the respondents

57. **Mr Taylor** is a chartered surveyor and a member of the Institute of Arbitrators. As head of the National Primary Healthcare team of GVA, he has 16 years experience of negotiating development transactions on new surgery developments for GP practices, specialist third party developers, investors and Local Improvement Finance Trusts (LIFTs). He explained that he had been closely involved with the DRRS as defined, prior to 1 April 2004 under the SFA (that being the relevant determining provision at the AVD), and subsequently under the superseding NHS Premises Costs Directions 2004 (which were relevant to post AVD assessments), and with CMRs. Some PCTs appoint valuers from private practice to undertake the DV's role in setting

CMRs, and he said he had dealt with one case (in Bromley) where he had effectively stepped into the shoes of the DV although he accepted in cross-examination that that was a rent review situation. He was also, he said, on an RICS panel advising on CMR procedures.

58. He said he had been asked to set out the different bases of reimbursement of rents (cost rents, notional rents (owner occupied premises) and lease rents (let premises)), the role of the DV in practice, to explain the effect landlords' "step in rights" have on value and to comment on whether notional rents are used to inform value on lease rents. He was also asked to comment upon PCT and other health user rents which were outside the DRRS, and whether or not they could be seen to represent open market transactions. It was agreed that cost rents were not relevant in this instance. That basis of calculation was not often used and it was removed in the 2004 Costs Directions.

59. It having become an issue as to which comes first in the development process for new, purpose built GP surgeries – the assessment of the notional or lease rent under the VFM principles or the CMR, Mr Taylor expanded upon his evidence on the sequential process in examination in chief. The process was also set out in simple tabular form in Mr Gallagher's rebuttal to Mrs Paraskeva's report at bundle 3, page 796. Mr Taylor said that either a GP Practice or a third party developer may approach a PCT having established that there is a requirement for new, purpose built GP facilities in a particular location, or a PCT may itself have already identified that there is a need for a new surgery in this location. Outline proposals submitted from either existing or new GP Practices or third party developers were initially assessed by the PCT which, if it considered they merited further consideration in line with their wider or overall priorities, would request a full and properly costed business case. That business case would indicate the preferred procurement route. If it was considered, on the face of it, to be viable, funds would be allocated in accordance with the PCT's budget provisions. A detailed scheme would then be worked up in the form of a development appraisal including design, size, accommodation and layout, Strategic Services Delivery Plan and a host of other relevant factors. Final confirmation of funding would be conditional upon the DV considering that the project represented value for money.

60. The DV would then adopt a residual valuation approach from which the initial lease or notional rent was derived as a product. The specific procedure which was followed for assessing the rents to be reimbursed in third party developer proposals was set out in the NHS Estates document: "A Guide to the Provision of Leasehold Premises for GP Occupation" published in 1999, and thus relevant at the AVD. That document, Mr Taylor said, provided useful guidance to the DV in assessing the viability of the proposals. Relevant extracts include:

> *"... the level of rent assumes critical importance in establishing the viability of the project for the developer as well as forming part of the value for money assessments carried out by the HAs..."*
>
> *"... The developer will be anxious to establish the likely level of rent early in the process... For this reason, HAs are encouraged to involve the DV in early discussions with the GP and developer. It is for the HA to instruct the DV to give an initial*

assessment. This reduces one of the major risk elements as perceived by the parties and therefore contributes to the overall viability of the project…"

"… Not only is the rent one of the most critical factors in a development appraisal, it is the most sensitive (confirmed by research commissioned as part of the production of this Guidance). Typically, a 10% variation on rent can give a 100% variation on profit for the developer…"

Therefore, he said, the most important aspect to all parties was the level of rent reimbursement that the GP Practice would receive from the PCT, that figure being based upon the initial assessment of CMR by the DV which was however subject to final review once the development was completed. The DV's consideration of the development appraisal would include an appraisal of the initial rent being sought by the third party developer on the GP accommodation, and the impact that (non-reimbursable) rents and capital premiums from other potential occupiers such as pharmacies could have on that initial rent. He would then meet the developer and, as Mr Taylor said "chew the fat" over the figures provided to assess deliverability and then arrive at a rental sum which is a product of that appraisal process. The actual CMR, he said, would differ from the lease or nominal rent in that it will be adjusted (usually by 5%) to allow for the specific lease terms that had been explained by Mr Gomersall. The rent could not be viewed in isolation from other factors affecting the viability of the project, such as abnormal site or building costs. There may be situations where due to the acute need for facilities in a particular location it was essential for the development to proceed even though on the basis of an appraisal it did not appear viable. It was inevitable therefore that, in such circumstances, the DV's assessment of the initial CMR may be higher than the 'tone' of DRRS rents in the locality. Mr Taylor gave examples of two schemes where this had occurred: Moreton-in-Marsh and Minehead. This demonstrated that initial CMRs on modern GP surgeries are a function of the development cost of the property, and whilst all the parties involved in the process adopted best endeavours to ensure value for money, ultimately the rent finally agreed was subject to cost and budget approval by the PCT. Where such higher CMRs were adopted, they became a part of the body of evidence in the DRRS.

61. In response to Mr Gomersall's evidence about the CMR coming first, Mr Taylor said that he had never come across an occasion when that was the case. The CMR was evolved from the initial lease rent valuation which was needed at the outset to enable the developer to decide whether the project was viable and to obtain the requisite funding. The CMR could thus be described as appraisal led in the context of these new developments. To all intents and purposes the assessment for value for money and the assessment for the CMR were virtually one and the same thing, although he accepted in cross-examination that they fell under different headings in the guidance set out within the SFA. On his inspection following completion of the development, the DV's final report would include the confirmed CMR to be reimbursed to the GP Practice.

62. Regarding rents paid for accommodation within multi-occupied Primary Care Centres by PCTs and other health users, Mr Taylor said that in his experience, although they were not reimbursable under the DRRS, they were assessed in much the same way as those under consideration in this appeal. Although not reimbursed under the DRRS, such users receive a budget for property costs from the department of health. The rents paid by these users tended

to be at similar levels to the CMRs initially and on review, as landlords were most unlikely to agree rents that were lower as that would affect their return on investment.

63. In summary, Mr Taylor said that all this evidence of the procedures involved for setting the CMRs proved that rents that were reimbursed under the DRRS do not represent true open market rental value. The figure reimbursed would not reflect the rent that a GP as tenant would be prepared to pay if vacant and to let on the open market. This was because by their very nature purpose built GP surgeries were bespoke units which were not developed speculatively. As they were never vacant and to let the DRRS rents could not be tested outside of that scheme. The processes for the assessment of the rents under the DRRS are the subject of statutory control, and the CMRs are intrinsically linked to the cost of development. Initial CMRs on third party leased premises are assessed according to the building cost of each specific project and these figures, which are fed into the DRRS were used for reference in ongoing rent reviews under the leases. Thus, they created a self-sustaining level of value.

64. In cross-examination, Mr Taylor insisted that whilst the wording of the relevant sections of the SFA and of the NHS Directions which came into effect on 1 July 2004 was slightly different, it did not affect the substance of what the DV was required to do in the VFM and CMR exercises. The VFM figure for rent and the CMR were, in broad terms, the same apart from the adjustments to reflect non-standard lease terms that he had referred to in his evidence. He agreed that paragraph 10.5.5 of the GN10 Guidance Note invited comparison with market rents when assessing the CMR, but he said he had always understood that this guidance related to capital valuations and in any event one needed to consider the document as a whole rather than picking out specific sentences.

65. Mr Kolinsky referred Mr Taylor to one of Mrs Paraskeva's appendices [bundle4/2 p1064] and a schedule of comparable rents at p.1070, to suggest that CMR rents were comparables based. Mr Taylor said that this evidence related to the rent review in 2011 on Dovercourt. Rent reviews, it was accepted, were not appraisal based but the figures were derived from other CMRs in the district. Taken then to Mr Gomersall's statement at paragraph 7.1 of his report, that market evidence of comparable lettings in the same use class were to be taken into account, Mr Taylor said he thought that was a somewhat contentious point. Only other purpose built GP surgeries were helpful because of the unusual and high specification level of fit out. It would be dangerous therefore to compare with other potential or actual uses which may be very different.

66. **Mrs Paraskeva** has 18 years experience dealing with rating list appeals and is the Lead National Director of GVA for the Emergency Services dealing with the rating assessments of specialist police hereditaments, fire and ambulance stations, hospitals and primary care hereditaments. She said that due to the national significance of the issue in dispute, the parties had agreed to select the three hereditaments in this appeal as test cases.

67. She said that the VTE was right to reject the rentals method as there was no evidence of rents being freely fixed on a vacant and to let basis in the open market for purpose built GP surgeries that were capable of providing an accurate indication of what a property might

reasonably be expected to let for from year to year in accordance with the definition of rateable value. There was no willing negotiation between landlord and tenant, and the rental evidence relied upon by the appellant is not conclusive of value of occupation to the occupier. The VTE, she said, was right to adopt the contractor's method. It was the only method that properly took into account reimbursement, was long established and was used for a range of public sector buildings including PCT healthcare accommodation.

68. As to the VO's role, Mrs Paraskeva referred to the current rating valuation basis set out in the VOA's Practice Note 2: "2005: Primary Care Centres/Surgeries (GP)/Health Centres", which was, in part, agreed with rating agents advising NHS Trusts throughout the country. That draws a distinction between surgeries occupied by GPs and those occupied by PCTs. Those properties occupied by GP surgeries, according to the Practice Note, are to be valued by the rentals method applying evidence from the DRRS, whilst PCT health centres are valued on the contractor's basis. However, she noted that the section relating to the rentals basis included the words: *"Rents that are related to the cost of construction or a return on that cost such as LIFT rents will be of little assistance…"* All the settlements that she had agreed on modern purpose built GP surgeries had been on the contractor's basis, but appeals she had been involved with on small GP surgeries within converted residential dwellings had been on the rentals basis, with comparables taken from other uses such as offices and retail because they were not specialist properties and could be used for other purposes. She went on to say that prior to these appeals, the VOs with whom she had been negotiating never made mention of the DRRS rents to support their assessment of rateable value. So whilst they would have been aware of the DRRS scheme, they chose to ignore rental evidence from those properties within it.

69. Mrs Paraskeva pointed out that GP surgeries are specialised, bespoke buildings the development of which was fully funded by PCTs, and which were never vacant and to let in the open market. CMRs reimbursed to the occupier were therefore not assessed in the conventional way where a tenant would be seeking the lowest rent possible, whilst the landlord would be seeking the highest. She said that she had investigated the DRRS in great detail and by adopting the fundamental principles of rating valuation when considering the weight to be applied to evidence underpinned by the DRRS, had concluded that there was no reliable rental evidence available in respect of this type of property. As a result, therefore, of the insurmountable complications caused by the funding regime for purpose built GP surgeries, her view was that the contractor's basis must be the only appropriate method to adopt, being widely recognised and accepted as the method of choice for the valuation of public sector interests. The appellant had conceded that rents underpinned by the DRRS were not open market rents (as recorded at paragraph 16 of the VTE's decision), but nevertheless still sought to rely on that evidence. DRRS rents were linked to the cost of development and were based upon the DV's opinion of value rather than being freely negotiated in the open market.

70. As to the DV's assessment of notional or lease rents, which was set out in paragraph 1 of Schedule 4 to the SFA, and with which Mr Taylor had dealt in his evidence, Mrs Paraskeva reiterated that CMRs only normally differ from the notional or lease rent where the repairing and insuring obligation differs from the standard CMR definition or, for instance, where the GP practice had chosen to take a proportion of the accommodation at its own cost. That was also

accepted by the appellant in the VTE proceedings, and thus it was clear that the CMR, being derived from the notional/lease rent, was based on the cost of development.

71. There were insurmountable differences, Mrs Paraskeva said, between rents reimbursed under the DRRS and rateable value. The statute under which assessment of notional and initial lease rents valuations were operated, the definitions used to determine the CMR and, critically, the effective removal of the landlord/tenant relationship under the DRRS have created such distortions that it was only logical to conclude that one statutory basis of valuation cannot inform another. The definition of CMR as being the opinion of the DV following negotiation with the developer landlord was different from the assessment required under the rating hypothesis based upon a rent agreed between a willing landlord and willing tenant (see *Lotus & Delta*). The DV was neither the willing landlord nor the willing tenant and was effectively controlling the level of rental reimbursement. Further, there was no means by which the DRRS assessment could accord with the assumption that the premises were vacant and to let.

72. The disregards in the CMR definition – that the DV should ignore both the effect of reimbursement and the fact that there would only ever be one GP practice in the market for the property – do not accord with the rating principle of reality. The fact remained that there would be no open market rental evidence on purpose built GP surgeries in the real world either with or without reimbursement. Mrs Paraskeva also said that there was an issue with the valuation date. There would have been very few CMRs assessed as at the AVD of 1 April 2003, and adjustments using comparables would therefore be required to bring them into line with it. That again would be an impossible task due to the fact that there were no open market of comparable properties outside the scheme on which to base any such adjustments. All of these distortions have led to a CMR 'tone' that is supported by nothing other than development costs and opinion.

73. Mrs Paraskeva went on to consider the specific assessment for each of the hereditaments. Regarding Dovercourt, of which Dr Read and Partners took a lease commencing 12 May 2008 at an initial rent of £113,000, the whole of that sum was reimbursed under the DRRS as the lease in that instance mirrored the terms to be assumed in the CMR definition. She set out as appendices details of the DV's interim report, his heads of terms, his final report and relevant extracts from the lease. As to the DVs interim report, it was to be noted that he set out the details of the design specification which confirmed the bespoke nature of the development. He also confirmed the initial rent agreed between himself and the landlord, but did not provide any rental evidence used in his assessment. In his section "Recommendations and Value for Money Considerations" he said:

> "All the costs of development have been appraised and negotiated including initial rent; capital value on completion (based on rent and investment yield); land value; building costs; professional fees; taxation (eg VAT and Stamp Duty); finance costs; cash flow timing and developer's profit."

This clearly demonstrated, she said, that the initial rent on Dovercourt (and thus also the CMR) were linked to the costs of the building. In the DV's final report, some 14 months later,

there was no adjustment to the rent, thus further proving that the rent and CMR were linked to the development appraisal rather than market rental comparisons.

74. Mrs Paraskeva said that she had had detailed discussions with Mr Ashley Seymour, the development director of Matrix Medical (the landlord) who was unable to provide a copy of the actual development appraisal, but had confirmed in an email that "…the initial lease rent…is a rent which had regard to a development appraisal. Consequently it is unreliable as a method of valuation given the numerous variables…(e.g. land cost, build cost, yield, interest rate, abnormals etc." The email correspondence stated also that rent reviews were to market value but Mrs Paraskeva said that there was a proviso that it was not to exceed the reimbursement assessment by the DV (see paragraph 76 below). The DV's opinion would again be based upon rents in the DRRS scheme, and therefore the same concerns also applied.

75. She said that PCT rents were tarnished with the same brush as DRRS rents. The DV advised the PCT on his opinion of value, again based upon the development appraisal, and where PCT's were leasing accommodation within new GP surgery developments, the DV would assess and apportion the rent between occupiers, and an appropriate adjustment would be made.

76. Mrs Paraskeva then turned to the question of tenant "safeguarding" clauses and "step-in rights" in respect of rent reviews. The leases of Dovercourt and Fairlawns contained a proviso restricting the rent to be agreed on review which safeguarded the tenant from having to pay more than the figure assessed by the DV for reimbursement purposes (i.e. the CMR adjusted for any differences in lease terms). Many rent review clauses (although not those relating to the appeal hereditaments) also included what were known as step-in rights which provided for a landlord to effectively step into the tenant's shoes by acting as the tenant's agent in respect of the appeals procedure to the NHS Litigation Authority that comes into play when the landlord and the DV were unable to agree the review rent. This was because it was recognised that the rent was effectively a "pass-through" cost to the GP tenant and as a result the tenant would be ambivalent as to the final rent agreed so long as the DV approved it for reimbursement purposes. Landlords were, therefore, securing the right to negotiate on behalf of the GP tenant in the interests of trying to achieve the highest rent possible in order to protect the value of their investment. The step-in rights were necessary because there was no legal relationship between the third party landlord and the PCT which reimbursed the GP Practice based upon the CMR, and it was only used where the landlord was of the opinion that the CMR was higher than the DV's assessment.

77. This lead to the bizarre situation, Mrs Paraskeva said, where a tenant was effectively seeking a higher rent than was being proposed by the DV, and that would never occur in the real world. It was another example of the rent (and thus the CMR) being a product of the funding mechanism and thus not being a reliable indication of the value of occupation to the occupier. Further, the safeguarding and step-in rights were not features of an open lettings market and were thus far removed from the requirements of the rating hypothesis.

78. The rent review on Dovercourt was understood to be still outstanding, she said, and as the DV's assessment was below the developer landlord's, it was likely that this would be appealed to the NHS Litigation Authority. Irrespective of this dispute, it was clear from his report that the DV's opinion of value was based upon other DRRS rents, including a notional rent reimbursed to the owner occupier of a new development where the rent was linked to cost. Whilst the DV's report related to a review many years after the AVD, it demonstrated that all of the evidence relied upon was subject to the same distortions that occur in respect of the initial lease or notional rent, and so the figure will not be representative of the tenant's bid as they are not involved in the setting of the rent.

79. Mrs Paraskeva said that the current rent on Dovercourt equated to approximately £165 per sq m on net internal area, and that figure did not in any way reflect the value of occupation to the occupier because it was underpinned by the cost of development and other viability considerations to provide an acceptable return to the landlord. In an area of social and economic deprivation such as where Dovercourt was located, an open market rent at this level would simply be unachievable. This was demonstrated by a lack of transactions in the area outside the DRRS, and the lack of interest in the vacant space in the building which has remained unoccupied since it was built. It was obvious, she said, that the landlord would not wish to let the available space for less than the level of the CMR, as this would have a detrimental impact upon their ability to negotiate an increase in the CMR.

80. Turning to Fairlawns, the circumstances were similar to those she had referred to in respect of Dovercourt, and thus the same arguments applied. However, in that case she had been able to see the final development appraisal, provided by Mr Christopher Proctor-Smith, Development Director of United Healthcare Developments Ltd, the third party developer landlord. He had confirmed that the CMR for both the GP and PCT accommodation was based upon the development appraisal. The proposed occupation by a pharmacy (not reimbursed) was taken into account in the calculation of the CMR.

81. Tramways, being an older unit (constructed in 1993) had its initial CMR calculated on a cost rent basis, but at the last rent review in 2011, Dr Poyser & Partners expressed a wish to move from the cost rent basis to the notional rent reimbursement basis due to the higher CMR assessment that would result. As Mrs Paraskeva had explained previously, it did not reflect the rating hypothesis when an occupier sought a higher rent in order to protect its investment.

82. Mrs Paraskeva then went on to set out in considerable detail the information she had been able to obtain in respect of the other GP surgeries that Mr Gallagher had referred to in his comparables schedule, including Owlthorpe Medical Centre, Sheffield which the VTE had said was a strong comparable. All of this evidence, she said, supported the arguments that have been set out above. She concluded that none of it could be deemed a reliable source of evidence, and further investigation generally had also failed to unearth any comparable rental evidence within the same mode and category of occupation that could persuade her not to reject the rentals method in respect of the appeal hereditaments.

83. Turning then to the contractor's method, Mrs Paraskeva provided a full commentary as to its primacy and principles. She said it was clearly the appropriate method to use (that fact being in any event agreed between the parties if the rentals method was found to be inappropriate). It was the method of choice in the rating valuation of a wide range of public sector assets including healthcare premises, and was the primary method used by her. I do not consider it necessary to summarise Mrs Paraskeva's lengthy and detailed evidence on this method due to the fact that the issue for me to determine relates to the appropriateness or otherwise of the rentals method, and the fact that there is no dispute as to the use of the contractor's method in the alternative, renders that evidence superfluous for the purposes of this decision.

84. Mrs Paraskeva said that DRRS rents were not open market rental transactions nor were they demonstrative of the value of occupation to the occupier. The VTE in reaching its decision was not simply searching for paradigm evidence of open market rental transactions as suggested in the appellant VO's statement of case. If it was, it would simply have dismissed the VO's evidence in the knowledge that it was common ground between the parties that no open market rental evidence existed. Instead, it was clear that the VTE had fully considered all of the evidence available in accordance with *Lotus & Delta*, regardless of the fact that DRRS rents were not agreed in the open rental market. The VTE determined that in the absence of an open rental market to test the reliability of DRRS rents, such rents could not be said to accord with the definition of rateable value and therefore the rental method could not be reliably applied to the rating valuation of purpose built GP surgeries.

85. As to Mr Gallagher's evidence, Mrs Paraskeva said that he had asked himself the wrong question as to whether or not the existence of an open market was imperative. He should have asked whether the evidence from other DRRS rents was reliable for rating purposes. He accepted that this was not an open market, and there was no speculative market in the provision of surgery accommodation as demand only existed to meet specific requirements. However, he had said there was an "actual market", but Mrs Paraskeva said it would be reasonable to conclude that by that he meant a controlled market. She was aware that the rating hypothesis did not state that it was imperative to rely upon open market evidence, but rating case law dictated that open market evidence was the best evidence, and that any rent which was the subject of statutory intervention should be treated with extreme caution. Mrs Paraskeva said that she did not agree with Mr Gallagher's reference to the contractor's basis as a method of last resort – it was the primary basis of valuation in a multitude of public and healthcare cases.

86. In a lengthy cross-examination by Mr Kolinsky, Mrs Paraskeva agreed that the PCT was the party responsible for paying the rent, as they reimbursed the GP Practice. But she did not accept that that effectively put the PCT in the position of the tenant. Whilst the PCT had the final say as to the amount of CMR it would reimburse, the decision was driven by the DV who also advised the PCT as to the Value for Money considerations which form the key to the initial or notional rent. The premises were not vacant and to let in accordance with the requirements of the rating hypothesis, and the only option for the GP (who was the tenant) was to go the PCT route, and the PCT must ensure that the CMR accords with the VFM principle. She did not agree with the suggestion that because it was the PCT who was obliged to deliver the healthcare service for which the GP surgery has been provided, the rent they were prepared to reimburse was a real-world reflection of the value to them of delivering that service.

87. As to Mr Gallagher's opinion that whilst it was common ground this was not an open market but an actual market, Mrs Paraskeva qualified that by saying it was an actual *development* market, although she accepted that it was a market that the GP Practice willingly choose to enter. She acknowledged that they could be described as active and informed participants, as could the PCT, but that was in accordance with its statutory duties. The developer landlord, she said, would have nothing to deliver until the requisite funding was in place, and the rent to be received had to be known at the outset. Until all the pieces of the jigsaw were in place, including the proposed heads of terms for the occupational lease, all that would be on the table was a scheme, not a market.

88. In connection with the rating hypothesis, Mrs Paraskeva accepted as common ground that all parties were acting in the knowledge of the reimbursement process and that the DRRS should be taken to exist in the hypothetical world. She also acknowledged that the DV had to disregard the effects of the DRRS and the fact that there was only one tenant in the market. Whilst she agreed that some of the assumptions, including that there would be equality of supply and demand, would apply to the appeal hereditaments, she did not accept that it could be assumed other suitable buildings would be available in the hypothetical world, or that the premises were vacant and to let. In those circumstances, it could not be assumed that there would be a willing negotiation between landlord and tenant. Whilst Mr Kolinsky suggested that the hypothesis was only relevant to the extent necessary to disregard reality, Mrs Paraskeva said it was her understanding that in "taking reality into account subject only to giving full effect to the statutory hypothesis" meant what it said. Where reality did not give full effect it should be held to be unreliable in rating terms.

89. Referring to *Orange PCS Ltd v Bradford (VO)* [2003] RA 141 (LT); [2004] RA 61 (CA), Mr Kolinsky pointed out that the telecommunications company's statutory right of free occupation was disregarded because it conflicted with the assumptions embedded within the rating hypothesis. In other words, the reality that was disregarded was the ability to take occupation without a transaction. Mrs Paraskeva did not read the judgment to mean that. What it meant was that the level of rent payable in reality (whether nil or a reduced amount due to some statutory intervention) did not mean that the property had either no, or a limited rental value in the real world. In that case the appellant had been arguing that because there was a right to free occupation, the land had no value for rating purposes. She set out in paragraph 22(d) of her rebuttal report the reasons why Mr Gallagher's comparison with the *Orange* case was erroneous.

90. Regarding the use of real world rents in the rating hypothesis, Mrs Paraskeva said she did not agree with the suggestion that her statement that "there is no open market rental evidence on purpose built GP surgeries in a world without reimbursement" should be struck out. All evidence was, of course, admissible; it was just a question of the weight to be applied to it. She said she had no problem with reimbursement in both the real and hypothetical worlds, but the fact remained that the level of reimbursement did not reflect the value of occupation to the occupier.

91. Referred to the RICS Guidance Note, and the statement in GN 10.5.5 that says it is possible to make adjustments between CMRs and market rent, Mrs Paraskeva was quick to point out that paragraph 10.1 relating to the application and scope of the GN says it does not apply to valuations carried out under statutory provisions. Although she was familiar with the document, she did not use it in rating valuations for that very reason as the guidance was aimed more at capital valuations.

92. Suggesting that the crucial point she had failed to recognise was that a correct understanding of the hypothetical market failed her test of an open market, Mr Kolinsky said this was an important aspect for the Tribunal to consider. Mrs Paraskeva said she agreed this was a key point, but insisted that her understanding was correct. In the real world the premises were never vacant and to let, so it was not possible to gauge or test value of occupation to the occupier.

93. Whilst she accepted that the DV was independent, unbiased and a recognised source of expertise, the caveat was that the DV was effectively standing in the shoes of both the landlord and tenant. She reiterated that the DV's assessments were appraisal based, and said that when that approach was used it was essential to turn to the contractor's method for all the reasons that she and Mr Taylor had argued. It was only under that basis that the true value to the tenant could be determined. The development profit in the appraisal could not be imported into the rating hypothesis, she said, due to the low decapitalisation rate that was used.

94. In respect of the agreed fact that PCTs who occupy accommodation within GP surgeries and who are not reimbursed under the DRRS, pay similar rents to the CMRs, Mrs Paraskeva said their rents were normally set as a percentage of the CMR based upon the proportion of the overall accommodation that they occupy, Fairlawns being a good example of how PCT rents are set. Some of the PCT leases mention the fact that rents were assessed on a CMR basis.

Submissions for the respondent

95. **Mr Lewsley** submitted that the VTE was correct to dismiss the rental method of valuation and to opt for the contractor's basis. Whilst the respondents were not saying that the rental method was to be ruled out as a matter of law, their case was that, as a matter of valuation judgement, no significant weight could be given to it as it was common ground there was no open market rental evidence of purpose built GP surgeries that could provide reliable evidence of the value of occupation to the occupier. Those comparables that were generated by the operation of the DRRS were particularly inappropriate for all the reasons set out in the evidence of Mr Taylor and Mrs Paraskeva. A more reliable method was therefore required, and the contractor's basis should prevail, that being common ground if I find for the respondents. It was long established and widely understood by valuers, and was commonly used for a wide range of public sector buildings. It is used for purpose built PCT Healthcare properties which are in the same mode and category of occupation as GP surgeries.

96. There were a number of reasons why the CMR assessed under the DRRS was not a reliable guide to rateable value. They were the DVs opinion of value which was not drawn from, or tested within, an open rental market. They were often appraisal based and linked to the DVs other duty – that of providing the initial, interim and final assessments of Value For Money which inform the lease rent – these usually being the same as the CMR. Neither the lease rents nor the CMRs were fixed on the vacant and to let basis as required under the rating hypothesis; they were clouded by development viability considerations and used a de-capitalisation rate in excess of that prescribed for the purposes of rating valuation. Whilst the CMRs were assessed so as to be consistent with each other, they have become a self-sustaining level of value which was not subject to any reality check in the open lettings market. The whole exercise, Mr Lewsley said, was completely divorced from the terms and requirements of the rating hypothesis. The DRRS was enacted for the specific purpose of funding the provision of modern, fit for purpose doctors' surgeries, and the CMR was a component within the funding mechanism. It was not intended to inform rateable values as it was not a market rent in the sense that term is used in rating valuations. Any reference made by the appellant to "real world rental evidence" related to its reliance upon the statutory scheme and was thus inappropriate for use as comparables when determining rateable values by the rental value method.

97. Mr Lewsley said that the law does, of course, provide the context, and whilst there are differences between the parties on the legal framework that forms that context, the respondents contended that those differences did not affect the key question that I have to answer.

98. The fact that the courts have placed high regard on rents agreed in the open market reflected the importance of the vacant and to let principle within the rating hypothesis. Any special or unusual conditions that might affect the rent were thus eradicated, including statutory intervention or controls, costs of construction or developer's profit. It was common ground (as admitted by Mr Gallagher in cross-examination) that nothing shall over-ride the vacant and to let assumption of the rating hypothesis, and it was further agreed that GP surgeries and PCT health centres were never speculatively developed and available in the open market. That fact was one of the fundamental reasons why the CMRs/Lease Rents did not satisfy the rating hypothesis, and were therefore unreliable in rating terms.

99. It was also common ground, it was submitted, that the objective of rating valuation was to establish the value of the occupation to the occupier. Case law confirming that included *Poplar Assessment Committee v Roberts* [1922] 2 AC 93, *R v Paddington Valuation Officer, ex parte Peachey Property Corporation Ltd* [1965] RA 177 and *Orange PCS Ltd v Bradford (VO)* [2003] RA 141 (LT); [2004] RA 61 (CA). Here, as in *Orange*, the GPs have a statutory right to occupy property free of charge, and where a statute removes the need for the tenant to negotiate with the landlord, the rent reserved is unlikely to provide a reliable measure of the value of occupation to the occupier. Mr Gallagher agreed in cross-examination that reimbursement removed the incentive to negotiate. Mr Gomersall also accepted that the tenant did not care what he paid, providing he remained cost neutral. The importance of the "higgling of the market" in the negotiation process was well established.

100. It was submitted that Mrs Paraskeva had considered the DRRS rents relied upon by the DV and concluded that because those rents were fixed in circumstances that were so far removed from the rating hypothesis, they did not form a reliable guide to the value of occupation to the occupier. That alone, Mr Lewsley said, should be determinative of the appeal.

101. Referring to the statutory basis of the DRRS, Mr Lewsley said that whatever the aim of the CMR definition, neither the SFA nor the 2004 Directions set out how it was to be assessed in practice, and it was left to the valuer to decide. The references that were made during the hearing to the RICS GN10 were, it was suggested, nothing to the point. The VO acknowledged that for rating purposes he had no regard to it, and relied upon the VOA's own guidance notes.

102. As to whether DRRS rents could have any use as evidence of rateable value, it was submitted that in the real world, the CMR and the initial lease rent or notional rent were usually the same thing, subject to the minor adjustments made to the CMR to reflect the real or notional lease terms that the SFA provides for. This was the position with all of the comparables upon which Mr Gallagher relied. With it being common ground that the CMR was fixed by the DV at the outset of the development appraisal process, Mr Gomersall had accepted that where the initial rent was either below or above the CMR, it was based upon the VFM development appraisal, but maintained that where it was the same (subject to the aforementioned adjustments) it was based upon a separate valuation process which used other rents – mainly other CMRs. However, Mr Gomersall also accepted that he had provided no evidence that supported that view. That, it was suggested, was implausible as representing normal practice, and Mr Taylor's evidence from his own experience over 16 years was to be preferred. The differences in the apparent experiences of Mr Gomersall and Mr Taylor were important, because it was well established that rents derived from development appraisals were not a reliable guide to rateable value – as indeed was clear from the VO's own guidance which stated that "rents that are related to the cost of construction or a return on that cost…will be of little assistance…"

103. Turning to PCT rents, the only evidence produced was of accommodation that PCTs shared with GP practices. Those rents were fixed in the same way as the GP rents, and the rent that the PCT paid was in proportion to the total accommodation that it occupied. Thus the argument that the PCT rents were in line with CMRs and above the rateable value assessed under the contractor's basis was wholly unsustainable. No evidence was put forward by the VO of stand alone PCT or health care premises, and it was acknowledged that the vast majority of those were assessed by the contractor's method. PCTs were also "special purchasers" and were in no better position to negotiate a bargain than a GP Practice.

104. In connection with the appellant's reference to *Allen (VO) v English Sports Council* [2009] RA 289 (*"Sport England"*), in that the availability of subsidy should not be disregarded in rating valuation, Mr Lewsley said that in the circumstances of this case that was not in dispute. However, at paragraph 8.15 of his closing he went on:

> "…It should be noted that *Sport England* is a contractor's basis case. It was agreed that the contractor's basis was the appropriate valuation method. The issue was whether grant

funded expenditure (i.e. expenditure at no cost to the landlord) should be disregarded in a contractor's basis valuation. It was held that all the capital expenditure should be taken into account because how the building was funded was not relevant to the value of occupation to the occupier. Another way of putting it is to say that the real world funding mechanism is irrelevant and the full capital cost should be taken into account irrespective of the funding mechanism. Consistent with this principle, the respondents have taken the full cost of the GP surgeries into account in their contractor's basis valuations."

105. In conclusion, it was submitted that the onus was on the appellant to show where the VTE went wrong – and it had singularly failed to do so. The contractor's basis was the appropriate method, and the rateable values on the three premises on this basis were agreed. The Tribunal was therefore urged to dismiss the appeal.

106. In response to the appellant's closing statement, Mr Lewsley said that it appeared to consist mainly of a convoluted step by step chain of theoretical reasoning about the rating hypothesis, designed to align the hypothetical world with the real world to justify the view that the actual real world rents were a reliable indication of value of occupation to the occupier. There was, he said, extensive case law against that approach and there was little reference in Mr Kolinsky's reasoning to the value of occupation to the occupier, the relevance and importance of 'vacant and to let' and to the 'prudent tenant', all of which were fundamental principles that could not be ignored.

Submissions for the appellant

107. Much of what **Mr Kolinsky** had to say has been summarised in paragraphs 19 to 27 above, and I will attempt to avoid too much repetition when considering his closing submissions. He said that Mrs Paraskeva's concession in cross-examination that the DRRS should be taken to exist in the hypothetical world (although Mr Lewsley pointed out that it had never been the respondent's case that it should not) significantly undermined the respondent's case. Mr Kolinsky then proceeded to set out at considerable length the core economic conditions of the real world as it affected PCTs, healthcare providers and GP Practices, and said that the position in the hypothetical world was all but indistinguishable.

108. The reality, he said, was that there was one entirely suitable property available on the material day to the only hypothetical tenant who would be interested in occupying it. The dynamics of supply and demand were therefore such that they were evenly matched. That situation was no different in both the real and hypothetical worlds. It was crucial, he said, to face up to the essential truth that the real world is a good proxy for the conditions that need to be assumed for the hypothetical world.

109. Mr Kolinsky said that, instead of facing up to where the comparative exercise between the real and hypothetical worlds took us, the respondents' case fell back on a number of assertions which they said negated the ability to use evidence from the real world. Firstly the arguments about the alleged lack of an open market. Mrs Paraskeva had accepted that the hypothetical

world would not meet her definition of an open market, and that was an important concession. The comparison of the real world evidence with the notion of an open market was the linchpin of the VTE's decision, and an essential feature of her written evidence, but in cross-examination it was accepted that the conditions that ought to be attributed to the rating hypothesis in the specific circumstances of this case could not properly be characterised as an open market. Thus, the VTE rejected real world evidence for not conforming to a paradigm which Mrs Paraskeva now accepted would not exist in the hypothetical world.

110. Mr Kolinsky submitted that in any event "open market" was not a concept that featured in rating law. It was familiar in rent review terminology, but one needed to be careful how it was looked at in the rating context. Mrs Paraskeva accepted that the conditions that ought to be attributed to the rating hypothesis in the specific circumstances of this case could not be properly characterised as an open market because there was no competition amongst bidders. It was thus erroneous for her to insert an open market condition into rating case law. The correct legal approach was that all evidence was admissible, and the question was what weight should be attached to it.

111. Adjustments could be made in forming an opinion based upon real world evidence. As Scott LJ put it in *Robinson Brothers (Brewers) Ltd v Houghton and Chester-le-Street Assessment Committee* [1937] 2 KB 445 at 469:

> "In weighing up the evidence bearing upon value, it is the duty of the valuer to take into consideration every intrinsic quality and every intrinsic circumstance which tends to push the rental either up or down"

And, at 470:

> The rent to be ascertained is the figure at which the hypothetical landlord and tenant would, in the opinion of the valuer or the tribunal, come to as a result of the bargaining for that hereditament, in the light of competition or its absence in both demand and supply, as a result of the "higgling of the market." I call this the true rent because it corresponds to real value… This true rent is often called "market value," but I hesitate to use that expression, as it seems to me prone to mislead, for it gives rise to the notion of something absolute, something having an objective existence, independent of all the various sources of demand, which together constitute the totality of demand."

That case, Mr Kolinsky said, highlighted that the assessment of value was an artificial thought process in which an opinion was formed from the available evidence, and the prudent valuer would take into account all relevant sources which offered an insight into the assumed world. The absence of supply or demand were material matters that would affect the deal struck by the hypothetical parties. Labels like "market" and, *a fortiori*, "open market" may be prone to mislead rather than assist. Therefore, he said, the rejection of evidence on the basis that it was not derived from an open market letting was mistaken.

112. Turning to the argument that the CMR was appraisal based, and that that was a reason for rejecting the evidence, Mr Kolinsky insisted that was simply wrong. Mr Gomersall, who has

extensive experience in determining CMRs, had explained that the DV made his assessment from a number of sources, including rents on other schemes within the DRRS and from lettings to D1 uses (e.g. PCTs) outside the DRRS. Comparative exercises were also carried out in review cases. Mr Taylor's understanding of the process was, it was submitted, also mistaken where he inferred that the VFM exercise was the same as the determination of the CMR. However, even if CMRs were appraisal based, that was not a reason for rejecting them – see *Lee (VO) v Southwark Manufacturing Ltd* (1961) RVR 230.

113. In respect of the "vacant and to let" assumption, Mr Kolinsky said that Mrs Paraskeva eventually came to accept in cross-examination that the willing negotiation contemplated in both the determination of rateable value and the CMR was a deal that would be struck between a landlord and tenant for the premises vacant and to let, so again the real world mirrored the hypothetical world. There was also no mileage in her arguments relating to "value of occupation to the occupier".

114. In summary as to the evidence, Mr Kolinsky submitted that the VO had available to him real-world evidence from lettings that closely mirrored the economic conditions that would apply in the hypothetical world; in which real money changed hands for the delivery of precisely suitable GP surgery accommodation for the benefit of both the GP Practice and the PCT, and in a system that had the requisite checks and balances within it. Further, he had corroborating evidence from lettings within the same mode and category of occupation at the same levels of rent outside the DRRS which demonstrated that values were not inflated.

115. Mr Kolinsky said that the respondents were wrong to assert that the VFM exercise undertaken by the DV and the CMR exercise were virtually one and the same thing. That showed, he said, a serious misunderstanding of the processes involved. The exercises were conceptually different. The DV would always seek to obtain value for money and would negotiate down the rental expectations of the landlord to the point where they corresponded to his opinion of the CMR. CMRs were derived from a comparative exercise, but the VFM assessment was a separate audit exercise on which projections of the rent achievable were input into the process.

DISCUSSION

116. The VTE decided that the contractor's method should be used because it was of the view that the route by which the DVS calculated its opinion of open market value did not appear to accord with the definition of rateable value in the rating hypothesis. In any case where there was a question over the availability, reliability or usefulness of rental evidence, there was no disagreement that the contractor's basis should be used. In his statement of case the VO referred to the ability of the valuer using the rentals basis to make any necessary adjustments, but there is of course also ample opportunity for adjustments to be made under the contractor's basis. This was dealt with at length by the President and A J Trott FRICS in *Allen (VO) v English Sports Council* [2009] RA 289 where their conclusions are set out in paragraph 77 at p. 315.

117. Mr Kolinsky put forward a strong argument against the adoption of the contractor's method, namely that "The valuations produced applying the contractor's basis produce the perverse outcome that purpose built GP surgeries have lower rateable values than patently inferior premises in converted premises." Indeed, he reminded me that the VTE had expressed reservations (at paragraph 36 of its decision). However, it seems to me, they gave a cogent reason why that was the case, saying that it was unavoidable because of the de-capitalisation rate used in the contractor's basis valuations.

118. He then referred to the schedule of both converted and purpose built premises occupied by doctors' surgeries and other D1 uses in Sheffield produced by Mrs Paraskeva at Appendix 22 to her report [p.1181 of the bundle]. These were in the same mode and category of occupation, and Mr Kolinsky complained that having rejected the rental evidence produced by Mr Gallagher, she had failed to take the next logical step of exploring the comparability of the premises within that list, many of which either she or other members of her firm had been directly involved. I have to say I find this complaint a little surprising. Mrs Paraskeva did deal with those in paragraphs 4.117 to 4.120 of her report, saying that she had "carried out a significant amount of research" and concluding that "My search for rental evidence on other D1 medical uses reaffirms my view that there is no rental evidence outside of the scheme to assist the DV in formulating an opinion of value on GP surgeries." I am satisfied with the reasoning she gave in those paragraphs and in any event, this was not evidence produced by the appellant, and the DV did not rely on it.

119. On the question of whether or not CMRs are appraisal based, it is clear to me from the evidence that the two defined roles of the DV in the process cannot be separated in the way that that the appellant suggests. I accept Mr Taylor's evidence that the CMR emerges from the VFM appraisal, as it has done in every one of the cases with which he has been involved over a period of some 16 years. Mr Taylor has, it is clear, considerably more experience in respect of CMRs than Mr Gomersall. I found his outline of the process by which GP surgery schemes develop from inception, and the DV's role therein very helpful. He referred to the 1999 Guide for the Provision of Leasehold Premises Occupied by GPs and the extract therefrom that he included was illuminating, particularly where it says "the rent is a critical factor of the development appraisal…" The DV therefore, he said, "arrives at a rental sum which is the product of that process." I accept his evidence that PCT and other healthcare use rents in shared premises are assessed in much the same way as CMRs.

120. I also accept Mr Taylor's arguments about why CMRs cannot represent open market rents and that as they are never vacant and to let, those rents cannot be tested outside the DRRS scheme. Further, Paragraph 51, Schedule 4(2)(ii) of the SFA says that the amount reimbursed shall be the lease rent or the CMR (whichever is the lower), and that is to my mind a further indication that subject to the adjustments set out, they must surely be derived from the same starting point.

121. Mr Gomersall said that there was no provision in either the SFA or the NHS Directions for the appraisal approach to be used, the appraisal being simply a tool to establish whether the development will be economically viable. In cross-examination he acknowledged that the CMR

normally mirrors the lease rent but said that the lease rent was not normally appraisal led. However, Mr Gallagher said that the DV's initial opinion of the CMR will be provided to the PCT/HA "for input into the viability assessment." He also said that the amount of the rent to be inserted into the pre-let agreement will be tested for robustness in determining whether or not the scheme will proceed. That again confirms my view that there was overwhelming evidence to support the argument that CMR's are appraisal based.

122. As Mr Lewsley pointed out, the appellant said that the respondents focused their criticisms on CMRs rather than lease rents. It was acknowledged that lease rents are the figure which appears in the lease (or are a notional rent where the GP Practice was also the developer) and which the GP effectively paid and was reimbursed for (after adjustments). Therefore, for all practical purposes they are one and the same thing. Rents based upon development appraisals are, as Mr Lewsley said, unreliable for rating purposes and do not accord with the strict requirements of the rating hypothesis. The tenor of the argument put forward by Mr Kolinsky in response to the respondents' closing submissions that the VFM and CMR exercises are completely different, actually strengthens my conclusion that the two are, indeed, inextricably linked. In my judgment, even if the CMRs were to be, as the appellant said, purely based on other CMRs, those were all matters of the DV's opinion, and I accept the respondents' submission that the whole issue then becomes a matter of opinion on opinion, self-sustaining and unreliable because of the potential for "error piled on error".

123. Whilst Mr Gomersall did say that where the CMR is the same as the lease rent it is derived from a "basket of comparables", I am satisfied that these were not based upon open market (or any other actual market) transactions and neither was the rent the subject of a willing negotiation between landlord and tenant. It could not be, for all the reasons set out in the respondent's evidence. Mr Gallagher indeed admitted that the CMR was not an actual rent but was a valuation undertaken by the DV for the purposes of calculating reimbursement – which is based upon the lease rent, adjusted accordingly. He also said that the original 2005 rating assessments were based upon "a less specific basket of evidence" and were related to schemes in a different mode or category of occupation which supports my conclusion that that there must be some doubts about the usefulness of those assessments as evidence.

124. Mrs Paraskeva helpfully referred to the VOA's Practice Note 2 which, whilst saying that the rentals basis should be used in valuing GP surgeries, contained an important caveat: that rents that are related to the cost of construction will be of little assistance. I note also that all the appeals with which she and her firm have been involved on purpose built GP surgeries have been argued on the contractor's basis. An important point she made, in my view, was that whilst the appellant has conceded that rents underpinned by the DRRS are not open market rents (as noted by the VTE), they seek to continue to argue the point. Indeed, Mr Kolinsky in his closing submissions made much of what he considered to be the irrelevance of the open market value argument put forward by Mrs Paraskeva. I am entirely persuaded by her argument (summarised in paragraph 71 above) that the assessment of CMRs is too far outside the rating hypothesis to provide reliable evidence on which to base a valuation using the rentals method. I also accept her evidence regarding the Dovercourt lease and the artificial consequences of "step-in rights" as proof that CMRs are appraisal based and therefore unreliable. Further, I agree with her that the RICS Guidance Note has no application in respect of valuations for rating

purposes as GN 10-1 clearly states that it does not apply to "valuations carried out under statutory provisions."

125. Much was made by the appellant of the fact that the PCT rents in shared premises were at the same or very similar levels to the lease rents upon which the CMR is based. The reason for this was, as explained by the respondents, that PCTs simply pay a rent based upon the proportion of the whole that they occupy. That this is so is clear from the heads of terms for the lease of Weston Lane Centre for Healthy Living in Southampton (Mrs Paraskeva's rebuttal appendix 7 at bundle page 1386) which says, in connection with rent safeguarding:

> "Rent safeguard
>
> Whilst the Lessee is entitled for the whole or any part of the demise to rent reimbursement under the terms of their National Health Service (NHS) contract at each review the Lessee shall not be required to pay a rent greater than the Current Market Rent reimbursed to the lessee by the PCT or as approved by the DV following negotiation or appeal/arbitration. Assura's solicitor to issue standard rent review wording for consideration and agreement.
>
> *Insert* For any part of the demise which does not qualify for reimbursement under the Lessee's NHS contract, the rent appropriate thereto shall be calculated at the same rate pro rata as the rent applicable to the reimbursed part, subject to the total rent payable for the reimbursed and non reimbursed areas not exceeding the Current Market Rent…"

126. In calculating the Value For Money Rent and the CMR the DV is being pulled in all directions – by the PCT/HA, the developer and the prospective tenant. From what Mr Gomersall said (and I accept he is not a rating valuer per se), I cannot possibly conclude that the exercise he carries out in determining the CMR is consistent with the rating hypothesis. It is only at best in part derived from consideration of a basket of rents, and a goodly proportion of that basket is made up of rents that are not open market rents and many are tainted somewhat by the DRRS scheme. It is noted that Mr Gallagher admitted that where both actual (lease) rents and CMRs are available, the actual rent is the better evidence of value. Once it is established that lease rents are often appraisal led, it cannot therefore be appropriate to consider them to be good comparables within the requirements of the rating hypothesis. This Tribunal's views on appraisal led valuations do not need to be repeated here, other than to say that they are only normally considered to be acceptable evidence where there is no other alternative available.

127. Whatever the strengths of Mr Kolinsky's arguments and, on the face of it, his references to relevant case law (including in particular *Robinson*), I am simply not persuaded by them. As Mr Gallagher admitted in cross examination, nothing should over-ride the vacant and to let assumption of the rating hypothesis. In the case of purpose built GP surgery developments the premises are never vacant and to let. There is also no competition. Further, I am mindful of the VO's rating guidance which warns of the dangers of relying upon rents that are related to the cost of construction or a return on that cost, saying that they will be of "little assistance". That is the situation in this case, and whilst I accept, of course, that in principle if there is rental evidence that can be adjusted to produce a reliable guide, it should prevail, I am not persuaded

that the evidence produced by Mr Gallagher is sufficiently close to the hypothesis for it to be reliable in this instance.

128. Even if I were to accept the appellant's arguments that the lease rents (and by definition the CMRs) are not appraisal based, I would still need to be satisfied on the evidence that the CMRs could be adjusted to reflect the fact that there is no transaction and the other factors by which the assessment falls outside the requirements of the rating hypothesis. However, Mr Gallagher referred only to adjustments to reflect the specific lease terms (where they differ from standard FRI leases) and produced no evidence of any other adjustments that might be deemed necessary to reflect those issues.

129. In summary, I have to conclude that I agree with Mr Lewsley's statement, set out right at the beginning of his closing submissions:

> "The key question is a matter of valuation judgment. The law provides context, and there are some differences between the parties on the legal framework that forms that context, but the respondents contend that these differences do not affect the answer to the key question, and therefore legal issues are not determinative of the key question and the RVs in issue in these proceedings."

I have considered a mountain of evidence and appendices, together with a list of no less than 20 authorities. But it seems to me that the answer is relatively simple, and in my judgment the VTE's decision was correct. I am not persuaded by the VOs arguments as to the nature of the lease rents or CMRs. They are just not reliable transactions, whether open market, market or not. They are not based upon the vacant and to let principle and do not reflect the value of occupation to the occupier.

130. The VTE was in my view right to quote the passage from *R v Paddington Valuation Officer* which precisely sums up the situation. Here, there are so many imponderables that the DV's CMR exercise cannot possibly provide a reliable basis for valuation on the rating hypothesis. I agree entirely with the VTE's observations at paragraphs 24 and 25 of its decision, and its conclusions at paragraph 30. I am not persuaded by the appellant's evidence or arguments that the VTE was wrong.

131. I found Mr Lewsley's closing submissions to be a helpful and concise summary of the respondents' case in respect of the issues and agree with his conclusions. Mr Gallagher accepted in cross-examination that nothing should override the vacant and to let principle and that the existence of the DRRS removes the incentive for the tenant to negotiate. These were important concessions, whereas those made by Mrs Paraskeva and latched on to as crucial by Mr Kolinsky in his closing statement I find to be nothing of the sort.

132. Finally, I really do not see how reference to Gibson LJ's statement in *Hoare* assists the appellant in terms of the principle of reality. The basis of assessment for CMRs is, in my judgment, about as far from the principle of reality as it is possible to get in terms of giving full effect to the statutory hypothesis, and there is no evidence to suggest that the parties are acting

on the basis of prudent lessor and lessee within the meaning of said hypothesis. In my judgment, the DV's role is compromised by the practical pressure to get the surgery built in order to cater for the demands of the populace for GP services. There is no point in having a CMR that is pitched at such a level that there is insufficient return for the developer, and he ends up walking away from the project.

133. For all the above reasons, I determine that the appeal is dismissed and the rateable values of the appeal hereditaments shall remain as determined by the VTE.

134. The parties having agreed costs, no costs addendum is required and the decision is thus final.

DATED 12 January 2015

P R Francis FRICS