

Welcome to Landmark Chambers'

Property in Quarantine

Part 4: Valuation Post-Covid

The recording may be accessed [here](#).

Your speakers today are...



Luke Wilcox



Aaron Walder

The Price of Everything or the Value of Nothing: Valuation during the Covid-19 pandemic

Aaron Walder and Luke Wilcox

Topics to be covered

- Introduction to the law and principles of valuation
- Covid-19 and valuation: the nature of the problem
- Case law relevant to the issues
- Judicial solutions: what is possible and what is likely
- Valuation in other contexts

Introduction to valuation

- Arises in many legal contexts:
 - 1954 Act lease renewals
 - Rent review
 - Compensation for compulsory purchase
 - Business rates and the Council tax
 - Certain property taxes

The nature of valuation

- Involves elements of law, science/arithmetic, and a healthy dose of professional judgment – as much an art as a science!
- The role of law:
 - Sets the framework within which the valuation exercise is undertaken
 - Critical first step in any valuation is to identify the features and parameters of this framework

Valuation frameworks

- LTA 1954, s. 34, if parties can't agree, rent to be determined as:

that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor, there being disregarded—

- (a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding,*
- (b) any goodwill attached to the holding by reason of the carrying on thereat of the business of the tenant (whether by him or by a predecessor of his in that business),*
- (c) any effect on rent of an improvement to which this paragraph applies,*
- (d) in the case of a holding comprising licensed premises, any addition to its value attributable to the licence, if it appears to the court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the licence belongs to the tenant.*

- Cf the framework for business rates valuation (LGFA 1988 Sch 6 para 2(1)):

the rent at which it is estimated the hereditament might reasonably be expected to let from year to year on these three 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 usual tenant's rates and taxes and to bear the cost of the repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command the rent mentioned above.

The limits of law

- Once framework is established, the role of the law is largely over:

“Ascertainment of the rent at which premises might reasonably be expected to let on the statutory assumptions is a question of fact, not one of law. The selection of the most appropriate technique to be employed in answering that question is a matter of valuation judgment rather than legal precedent.”

Hughes (VO) v York Museums and Gallery Trust [2017] RA 302, para 112

Valuation methodologies

- Depends, in the first instance, on the framework – what's suitable for an OM valuation differs from what's suitable for a valuation on an index-linked rent review clause
- For OM valuations, main method of valuation usually the comparables method

Comparables valuation

“It is a fundamental aspect of valuation that it proceeds by analogy. The valuer isolates those characteristics of the object to be valued which in his view affects the value and then seeks another object of known or ascertainable value possessing some or all of those characteristics with which he may compare the object he is valuing. Where no directly comparable object exists the valuer must make allowances of one kind or another, interpolating or extrapolating from his given data. The less closely analogous the object chosen for comparison the greater the allowances which have to be made and the greater the opportunity for error.”

GREA Real Property Investments v Williams [1979] 1 EGLR 121 per Forbes J

Comparables valuation: types of evidence

- Direct market evidence (transactions, asking prices)
- Indices
- Supply/demand data
- General market data (interest rates, FTSE movements etc)

RICS Professional Standards in Valuation: comparable evidence in real estate valuation (Oct 2019)

Other methods

- Comparables method not always available:
 - Lack of transactions (some properties of a type which rarely lets)
 - Lack of data on transactions
 - Lack of a coherent picture from transactions

- Range of alternative methods available:
 - Receipts and expenditure (R&E)/profits method
 - “Shortened” method
 - Contractor’s basis
 - “Tone”

The Current Problem

- Hypothetical Parameters
 - i. Acting for Landlord of premises trading as a restaurant;
 - ii. Claim brought for new lease in 2019;
 - iii. All terms agreed save for rent;
 - iv. Premises is 3000 SqFt;
 - v. Current rent (under old tenancy) £75,000 pa;
 - vi. New term 5 years.

Usual Method

- Work out rent on basis of price per square foot
- £25 per sqft
- Obtain expert evidence setting out
 - i. Passing rent for recent local restaurant transactions;
 - ii. Determination of rent in recent local restaurant transactions;
 - iii. Agreed rent review in comparable transactions;
 - iv. Determined rent review in comparable transactions.

Current Problems

- No (or very few) transactions are occurring at the moment
- Restaurants have only very recently started trading again after lockdown, and hospitality market is very cautious.
- Tenants are actively seeking to renegotiate rents (payment date and/or amount) based on business interruption
- The few transactions that do take place may be motivated by necessity or other factors that do not reflect the market.

Date of Valuation

- Rent Review
 - The date is fixed by the instrument giving rise to the review (usually the Lease). Thus it is set as an exact point in time.
- New Lease under the 1954 Act
 - In *English Exporters v Eldonwall* [1973] 2 WLR 435 the valuation date is the date of the new lease, which by virtue of s.64 is 3 months and 21 days from the date of the trial. In practice however, the Court must do its best with the evidence available at trial.

Any wriggle room with Valuation Date?

- Rent review
 - Actual exercise is usually done some time after fixed valuation date
 - *Segama NV v Penny Le Roy Ltd* [1984] 1 EGLR 109 concluded that a number of transactions on comparable properties which occurred after the review date were admissible in a rent review arbitration. Accepted as correct in *Currys Group Plc v Martin* [1999] 3 EGLR 165.
 - However, in *Gaze v Holden* [1983] 1 E.G.L.R. 147 Judge Finlay Q.C., in the Chancery Division, said:

"I have come to the conclusion that 'valuation in the usual way' means taking into account events which have happened at the date when the property falls to be valued-- in this case February 8, 1980--and taking into account not only the actualities of that date but the possibilities in relation to all the circumstances; and that the valuer has, as best he can, to form his own judgment as to how these possibilities and various prospects that are inherent in the then existing situation affect the value of the property as at that date; but he is not entitled to take into account events which happen subsequently and which resolve how these various possibilities and prospects in fact turn out. To do so would be to introduce into the valuation a species of full knowledge which would not be available to any willing buyer or willing seller entering into a contract as at the date on which the property falls to be valued."

- 1954 Act Valuations

- Slightly more argument here, since valuation date is not until 3 months after trial.
- In *Lovely & Orchard Services Ltd v Daejan Investments* [1977] 246 EG 651 Court held regard should be had...

“...to such evidence as there may be that indicates that any changes may have to be taken into account, being changes that the evidence shows are likely to occur between the date of the hearing and the date when, assuming that the court's order stands as it is made by the court, the new tenancy will commence”

- Needs to be some evidence of likely change in next 3 to 4 months.

Issues and Case Law

- What is to be done about the lack of transactions, and the very real prospect that there are unlikely to be any “willing” lessees of hospitality (or other) premises?
- *Dennis & Robinson Ltd v Kiossos Establishment* [1982] 2 EGLR 1220 noted that while there is no express mention of a “willing lessee” in section 34 (it speaks only of a “willing lessor”) the Courts assume one must exist because of the necessity of implying such a concept to allow for consideration of an open market letting

- The case of *FR Evans (Leeds) v English Electric* [1977] 36 P & CR 185 explains the nature of the "willing landlord" and the "willing tenant". It is noted that
 - the landlord is "*not afflicted by personal ills such as a cash-flow crisis or importunate mortgagees nor being someone to whom it was largely a matter of indifference whether he let in October 1976 or waited for the market to improve....*"
 - similarly, the tenant "*was a hypothetical person, not being, nor necessarily having any of the characteristics of, the defendant tenants, actively seeking premises to fulfil needs which the demised premises could fulfil, taking account of similar factors to those taken into account by the willing lessor but similarly unaffected by liquidity problems, governmental or other pressures to boost or maintain employment in the area and so on...*"

- What is to be done about the fact that the premises may not be able to be utilised or occupied as a restaurant?
- In *Northern Electric v Addison* [1999] 77 P & CR 168 there was a dispute regarding the rent of an electricity sub-tation, where there was a restriction preventing it from being used for anything other than a sub-station. The Court held that the narrowness of the user was a factor to be considered in calculating the value of the rent.

- Should only a nominal value be applied to an asset where there is evidence of no demand for it?
- Some support from tax cases such as *IRC v Grey* [1994] STC 360
- However:
 - “liquidity problems” & “government pressure” not a factor for willing tenant
 - “actively seeking premises to fulfil needs”
 - “which these premises could fulfil”

Where does all that leave us?

- A number of possible solutions exist
 - Agree the rent
 - Low rent, with an upward only rent review after a year
 - But added problem if tenant wont agree rent review provisions
 - Could well simply be putting the problem off to next year if there is still no comparable evidence or steadiness in the market

- Grant a short tenancy only, or a tenancy with a break exercised shortly
 - Much more risk for tenants if landlord is considering taking property back for redevelopment etc
 - Tenants may wish to rely on uncertain/lower rents
- Some other basis of rent other than size and location of property, such as turnover rent
 - Very radical wholesale change that may cause landlord's difficulty from an asset valuation point of view
 - No certainly for landlords

Most Likely Outcome(?)

- A rent free period to reflect the pandemic, followed by a rent set by pre pandemic comparables.
 - Certain
 - Based on sound valuation principles
 - Both landlord and tenant share risk (rent free period can be capitalised over life of lease)

Valuation in other contexts

- Covid-19 impact sounds differently in different contexts – but most will be affected in one way or another
- Everything turns on the framework for the valuation

Business rates

- Valuation assumes some characteristics (physical state of property, mode or category of occupation etc) at one date (called the material day), and everything else at another date (the valuation date)
- Valuation date for current rating valuations is 1 April 2015
- BUT change in material day factors can trigger a revaluation
- What would have been the impact on values in April 2015 if physical/locational consequences of Covid-19 were present at the time??

Business rates

- Number of other issues:
 - Are the impacts of Covid-19 “material day factors”?
 - Can the valuer take account of temporary nature of the Covid-19 impacts and restrictions?
 - Is the property occupiable at all?
- Potential for very significant reductions in rateable values

Rent review

- Key consideration is the review clause:
 - What's the valuation date?
 - Any factors taken at another date?
 - Based on OM value, or on something else?
 - Can change of use potential/development value be reflected?
- Remember – rent review ultimately contractual, so can always agree an alternative approach if too tricky

Capital valuations

- E.g. compulsory acquisitions, Council Tax etc
- Unlikely to have a meaningful impact ... we hope!

Thank you for listening

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London

180 Fleet Street
London, EC4A 2HG
+44 (0)20 7430 1221

Birmingham

4th Floor, 2 Cornwall Street
Birmingham, B3 2DL
+44 (0)121 752 0800

Contact us

✉ clerks@landmarkchambers.co.uk
🌐 www.landmarkchambers.co.uk

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