RA/7/2003

LANDS TRIBUNAL ACT 1949

RATING – non-domestic hereditament – district heating systems occupied by housing authority – whether domestic property – Local Government Finance Act 1988 section 66(1) – held domestic property – entries deleted from list

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE LONDON (NORTH EAST) VALUATION TRIBUNAL

BETWEEN **JOHN LESLIE HEAD** **Appellant**
(Valuation Officer)

and

LONDON BOROUGH OF TOWER HAMLETS **Respondent**

Re: District Heating Systems
London E1, E2, E3, and E14

Before: The President

Sitting at Procession House, 110 New Bridge Street, London EC4V 6JL
on 28 February 2005

Timothy Mould, instructed by Solicitor of the Inland Revenue, for the Appellant.
J P Scrafton, solicitor, for the Respondent

The following cases are referred to in this decision:

Martin v Hewitt (VO) [2003] RA 275
Hodgkinson (VO) v Strathclyde Regional Council Superannuation Fund [1996] RA 129
Eastbourne Borough Council v Allen (VO) [2001] RA 273

The following further cases were referred to in argument:

Fife Assessor v Fife County Council (1953) 46 R & IT 496
Swindon Borough Council v Tavener (VO) (1952) 45 R & IT 410
Hoare (VO) v National Trust [1998] RA 391
United Services and Services Rendered Club v Thorneley (VO) [2001] RA 145

DECISION

Introduction

1. In this appeal the appellant valuation officer appeals against a decision of the London (North East) Valuation Tribunal that eight district heating systems owned and operated by the respondent council to supply heating and hot water to council housing estates were rateable and should each be entered in the 1990 local non-domestic rating list for Tower Hamlets at a rateable value of £1. The hereditaments had been entered in the list at rateable values ranging from £5,025 to £70,650 and the respondent had made proposals seeking the deletion of the entries or alternatively reductions in the assessments to nominal values.

2. The council's primary contention is that each of the hereditaments is domestic property as defined in section 66(1) of the Local Government Finance Act 1988 and none of them are therefore rateable. The VO says that each district heating system consists entirely of property which is not domestic and is accordingly under section 64(8) a non-domestic hereditament. If the hereditaments are rateable the VO contends that the proper method of valuation is the contractor's basis and that the assessments that should be entered in the list are the ones that he had originally entered. The council argues that it is inconceivable that it would on the rating hypothesis pay a substantial rent for any of the DHSs and that they should be entered at a nominal value only.

The district heating systems

3. The parties agreed a statement of facts, and the VO, in a witness statement with supporting material, provided further factual evidence about the DHSs. The council called no evidence. On 10 March 2005 I inspected two of the boiler houses (at Glenkerry House and at Patriot Square) and saw the buildings that they served. On the basis of this I find the following facts. In describing the DHSs and their surroundings I use the present tense, although in some cases there have been changes since the material date.

4. Each DHS comprises a boiler house or room, supports for the boiler, a gas or oil fired boiler (which is not rateable under the Plant and Machinery Regulations), control equipment, chimneys, flues and distribution pipework. Each boiler house is kept locked, and only staff of the council have access, or can provide access, for servicing and maintenance.

5. The water heated in the boilers is pumped round a circulatory system of pipes leading from and back into the boilers and arranged as a two-pipe system with flow (outward) and return circuits. Pipework from the flow circuit enters each property. The heated water circulates round the property's central heating system, providing heat to the radiators, and passes through a copper coil inside the hot water cylinder, heating the domestic hot water. The water then leaves the dwelling and, flowing along the return circulatory system, it returns to the boiler.

6. Each block of dwellings, and each individual dwelling served by the system, can be isolated for maintenance purposes. The isolation valve for each dwelling is normally located adjacent to the hot water tank in the dwelling. The tenants or long leaseholders are expressly prohibited from interfering with the equipment. While it is technically possible for individual dwellings to be removed from the system it would be operationally undesirable to remove them as the system is designed to be operated in its entirety. The tenants or long leaseholders also cannot remove radiators or interfere in any way with the heating or hot water system other than by controlling the level of heat or by turning the radiators off or on.

7. The DHSs were all constructed by the London Borough of Tower of Hamlets between 1973 and 1976 as part of the council developments or estates that they serve. The dwellings connected to the DHSs are flats or houses which are held either on secure tenancies under section 79 of the Housing Act 1985 or on long leases purchased by secure tenants under the right to buy provisions of that Act. Each tenant pays a charge for the heating and hot water. This charge is shown as a separate item on the rental statement and the tenant is unable to opt out of the charge, which is payable with the rent. In the case of long leasehold premises the charge is included in the services charge that the lessee is obliged to pay.

8. Each hereditament is described in the rating list as "District Heating System". The addresses of the hereditaments and the assessments for which the VO contends are as follows:

Roslin House, Brodlove Lane, E1	£5,950
Glenkerry House, Burcham Street, E14	£5,250
Glamis Road, E1	£7,425
Gough Walk, E14	£13,100
Granby Street, E2	£7,475
Patriot Square, E2	£5,025
Teviot Street, E14	£30,550
Tredegar Street, E3	£70,650

9. The boiler house at Roslin House is situated on the ground floor under an outside stairwell. There is a 10 metre chimney. Roslin House is a 7-storey block of 54 flats, situated between Cable Street and Elf Row. All the flats in the block are served by the system. In addition flats in Cable Street and houses in Elf Row are served and also a tenants' meeting room. The total number of dwellings served is 106. The tenants' meeting room is not entered in the rating list.

10. Glenkerry House is a 13-storey block of 79 flats. The boiler house is of concrete construction and comprises the upper (14th floor) section of a lift and stair block on the outside of the building. In addition to the flats in Glenkerry House the system serves flats and a house in Burcham Street and also a launderette and a shop. The total number of dwellings served is 115.

11. The Glamis Road boiler house is of concrete construction and is situated in part of the semi-basement of a link block between flats in Cable Street. The link block also contains a caretaker's workshop, a tenants' meeting room, a shop unit and parking areas. The installation provides heat and hot water to 161 dwellings in an area bounded by Cable Street to the north, Glamis Road to the east and Redcastle Close to the south, and also to the other premises in the link block.

12. The Gough Walk boiler house is a building of brick construction with a flat roof, situated to the rear of flats in Hind Grove. There is a 25 metre chimney. Heating and hot water are supplied to 308 dwellings in Gough Walk, Piggott Street and Hind Grove.

13. The Granby Street boiler house is constructed of brick and mass concrete. It is situated under a high level entrance to Bentworth Court, a 6-storey block of 117 flats. In addition to these, the installation serves adjacent dwellings in Granby Street, Bethnal Green Road, Chilton Street, St Matthew's Row and Goldman Row, and an old persons club and a tenants club in St Matthew's Row. Neither of the clubs is entered in the rating list.

14. The Patriot Square boiler house is constructed of brick with a flat concrete roof. It is situated alongside Hugh Platt House, a 4-storey block of 18 houses, which it serves. It also serves flats and houses in the adjacent Ebenezer Mussell House, James Docherty House and William Caslon House. A total of 107 dwellings are served.

15. The Teviot Street boiler house is constructed of brick with a flat concrete roof. It has a 16 metre free-standing chimney. It is situated to the rear of premises in Zetland Street and serves 605 dwellings in blocks of flats and houses on either side of the Blackwall Tunnel Northern Approach.

16. The Tredegar Road boiler house is a free-standing industrial-type building of brick and profiled metal construction. It has a 50m chimney. It is situated on Morville Street and backs on to the main railway line between Stratford and Liverpool Street. The installation serves 1298 dwellings in blocks on either side of the railway. It also serves three shops and a tenants meeting hall, all of which are entered as hereditaments in the rating list.

District heating: statutory provisions

17. Under Part II of the London County Council (General Powers) Act 1949, as amended by the Local Law (Greater London Council and Inner London Boroughs) Order 1965 and section 45 of the Greater London Council (General Powers) Act 1969, the council of a London borough is a heating authority (section 4(1)) and has power to establish heating undertakings and to supply heat (section 5(1)) to any houses or other buildings in the borough. This power extends not only to houses sold, leased or managed by them as a housing authority, but to other houses and buildings as well. Any proposal to establish, extend or alter a heating undertaking or to construct, extend, modify or enlarge any station for providing heat for the purposes of a heating undertaking requires the consent of the Minister (now the First Secretary of State):

sections 11 and 12. Other sections of Part II of the 1949 Act give heating authorities powers to distribute hot water and steam, to install and maintain stations, boiler-houses and mains, to receive heat from and supply heat to other heating authorities, and to lay mains in streets.

18. Conditions of supply of heat may be contractually agreed between the heating authority and the owner or occupier of premises (section 20)(1)), and under section 22(1) the heating authority may make and recover charges for heat supplied and may from time to time prescribe scales of heating charges in respect of any heating undertaking established by them, although such prescription cannot affect any agreement in force under section 20. Heat supplied to any premises let by the heating authority is chargeable at the prescribed rate unless otherwise agreed, and the heating charges must be shown separately in rent books or on demand notes or receipts (section 22(2)). A heating authority in exercising their powers must not show undue preference to or exercise undue discrimination against any person (section 20(3)).

19. Under section 22(3) the heating charges in respect of a heating undertaking must be so fixed from time to time by the heating authority that as far as is reasonably practicable the total of the income shown in the revenue accounts of the undertaking is not less than the total of the expenditure shown in the accounts. The authority must credit the accounts with the amount of the heating charges that would be applicable to any heat supplied to premises of which they are the occupier (section 22(4)). Separate accounts must be kept for each undertaking (section 24), and an authority may provide a reserve fund and a repairs equalisation fund for any undertaking (sections 27 and 28).

20. Under section 108 of the Housing Act 1985 the Secretary of State has power to make regulations requiring heating authorities to adopt such methods for determining heating charges payable by secure tenants as will secure that the proportion of heating costs borne by each of those tenants is no greater than is reasonable. No such regulations have, however been made.

Rateability

21. Under the 1988 Act property is not rateable if it is domestic property. Sections 43(1) and 45(1) make liability to the non-domestic rate dependent on the hereditament being shown in the non-domestic rating list. Under section 42(1) only a hereditament that is a non-domestic hereditament falls to be included in the list. Under section 64(8)(a) a hereditament is non-domestic if it consists entirely of property which is not domestic. "Domestic property" is defined in section 66. Subsection (1) of that section (as amended) provides so far as material:

> "(1) … property is domestic if –
>
> (a) it is used wholly for the purposes of living accommodation,
>
> (b) it is a yard, garden, outhouse or other appurtenance belonging to or enjoyed with property falling within paragraph (a) above…"

For the council Mr J P Scrafton contends that each DHS is appurtenant to the dwellings to which it supplies space heat and hot water. Mr Timothy Mould for the VO rejects this contention. He says that in this statutory context "appurtenance" carries its common law meaning, that is to say, it embraces property that will pass with the principal subject matter of a conveyance without the need for express mention and is confined to the curtilage of the building in question. Mr Mould refers to my decision in this Tribunal in *Martin v Hewitt (VO)* [2003] RA 275 reviewing the earlier authorities. He says that, so explained, the concept of an appurtenance has no application to the present case. It is, he suggests, nonsensical to speak of the same property, the DHS, being appurtenant to a multitude of residential flats. No individual tenant has any possible claim to be entitled to the DHS by virtue of which he is supplied with heat and hot water. He may enjoy a contractual right to that supply as against the council, but he has no property in the physical means, the DHS, by which the council fulfil their obligation to provide that supply.

22. It is unnecessary for me in this decision to review again the cases that deal with the meaning of "appurtenance". I accept Mr Mould's submission that in this statutory context it embraces property that will pass with the principal subject matter of a conveyance without the need for express mention and is confined to the curtilage of the building in question. However, I reject his submission that, because no individual tenant can claim to be entitled to a particular DHS, none of the DHSs can be an appurtenance for the purposes of section 66(1)(b). There might, it seems to me, be force in that submission if the definition were so worded that, to be an appurtenance, property must appertain to a particular hereditament. If that had been what the provision had said one might have been constrained to look at each unit of occupation, each individual hereditament, and to ask whether the property was appurtenant to any such unit. But the definition of domestic property is not confined in that way. There is no reference to "hereditament" in subsection (1). Moreover paragraph (b) refers to an appurtenance "belonging to or enjoyed with" property falling within paragraph (a). While "enjoyed with" would imply considerations related to occupation, "belonging to" is apt to embrace considerations of ownership.

23. I can see no difficulty in concluding that the DHSs in the present case fall within paragraph (b). To take the case of Glenkerry House, perhaps the clearest example, the boiler house is an integral part of the 13-storey building, being situated on the top of the lift/stair block. The accommodation in the building is wholly residential. The purpose of the DHS is to provide heating and hot water to the residential accommodation. The building is owned by the respondent, and it is plain that the boiler house and the associated pipework within the building would pass on any conveyance of the building. The DHS can properly be said, therefore, to be appurtenant to the residential accommodation and to belong to it. I see no reason to think that different considerations would apply where the pipework extends so as to serve other adjacent buildings in the respondent's ownership, nor do I think that the very small extent to which, in some cases, non-domestic premises are also supplied would take any of the DHSs outside the definition of domestic property. Indeed Mr Mould said that distinctions should not be drawn between any of the DHSs in the present case if the conclusion was that any one of them was within the definition.

24. It would in any event in my judgment be contrary to the scheme of the legislation to hold that these systems, which are there to serve the residential accommodation, are rateable.

Together the 1988 Act and the Local Government Finance Act 1992, which repealed Parts I and II of the 1988 Act relating to the community charge and replaced the community charge with council tax, provide for rates to be levied on non-domestic premises and council tax to be levied on domestic premises. If the VO's contention was right in relation to systems by which a landlord supplies heat and hot water to his tenants, the same considerations would, it seems to me, inevitably apply to all those parts of the premises that the landlord provides to serve the tenants' residential occupation. Staircases, lifts, access ways, parking areas and gardens would, on the VO's approach, be non-domestic property because they would not be appurtenant to any one property used for the purposes of living accommodation. All would need to be entered in the rating list.

25. I conclude, therefore, that none of the DHSs that are the subject of the present appeal are rateable. The entries relating to them in the rating list should accordingly be deleted.

Valuation

26. Having reached this conclusion on the law, I think that I should also deal with the question of the values that would properly have been determined in the event that I had determined the question of law in the VO's favour (even though the terms of rule 50(4) of the Lands Tribunal Rules are not such, in the circumstances of this case, to require me to do so). I have set out above the rateable values for which the VO contended in the evidence that he gave. He reached these values using contractor's basis valuations. There is no need for me to set out these valuations (or any of them). It is sufficient to note that none of them contained any stage 5 adjustment. (In a contractor's basis valuation stage 5 is the point at which the valuer, having reached an annual value by decapitalising the adjusted replacement cost and the value of the land, forms a judgment as to whether that value truly represents the amount that the landlord and tenant on the rating hypothesis would agree as the rent.) The council called no valuation evidence. Mr Scrafton invited me to conclude, on the basis of this Tribunal's decision in *Hodgkinson (VO) v Strathclyde Regional Council Superannuation Fund* [1996] RA 129, that it was inconceivable that the council would pay other than a nominal rent in each case, and he contended that the VO's valuations were flawed in that they did not make any stage 5 allowances.

27. *Hodgkinson* concerned public conveniences in a shopping centre containing 48 retail units. They were provided by the landlord of the shopping centre and were available both to the tenants of the shops, 13 of which did not have staff toilets, and to the shopping public. The tenants were contractually bound to pay a service charge equal to the cost of providing services, including the conveniences. The Member (Judge Rich QC) concluded that the entry in the list should be at a nominal value only. He said ([1996] RA 129 at 140):

> "The appellant valuation officer, in giving evidence in support of a valuation other than nominal, maintained that if the conveniences were vacant and to let there would be at least two potential tenants who would have an interest in bidding for a lease: the owner of the centre and a consortium of tenants. I think that the issue as to whether a value more than nominal is to be attributed to the appeal property depends upon whether such potential bidders would, between them, bid the rent up. I think that Mr King gave the right answer to that question in his evidence in cross examination.

> He pointed out that the tenants of the retail units have to pay a service charge equal to the cost of providing the services including the conveniences. Any rent which the owner of the centre had to pay would be charged back to the tenants. It would not be in the interest of the tenants to bid against the owner, who would therefore either be the only potential tenant or would agree with the consortium that they should be the only bidders for the tenancy. In the hands of the hypothetical lessor, or of any third party, the premises, subject to the rights of the tenants of the retail premises would be burdensome and incapable of producing any income for him that was not exceeded by the expense of collecting it. The hypothetical lessor would not, therefore, be able to insist on more than a nominal rent."

28. In each of the present cases, Mr Scrafton said, it would be unlikely in the extreme that there would be any competition for a hypothetical tenancy of the DHS, and, having regard to the obligations of any public body in relation to public money, it was inconceivable that the council would pay a substantial rent for a property which was incapable of earning a profit and which would be left with the hypothetical landlord if the council were not to take it. In cross-examination Mr Head had said that he had not made a stage 5 allowance in these or previous contractor's basis valuations, and there would need to be something very special to make him consider it. In re-examination he said that he could see no special reason for making a stage 5 adjustment. Mr Scrafton submitted that I should take judicial notice of the state of local government finance, and the fact that the London Borough of Tower Hamlets was one of the poorer councils, as Mr Head had accepted in cross-examination, should be taken into account, he said, because it affected their ability to pay the hypothetical rent. He referred to this Tribunal's decision in *Eastbourne Borough Council v Allen (VO)* [2001] RA 273, in which the Tribunal (myself and Mr N J Rose FRICS) had accepted that constraints on local authority finances were potentially a relevant factor at stage 5, although we had found that the evidence did not justify such an allowance.

29. There are, in my judgment, three matters for me to decide. The first is whether Mr Scrafton is right to submit that it was inconceivable that, on the rating hypothesis, the council would be prepared to pay any money for any of these DHSs. The contention was advanced, not on the basis of any evidence (no evidence was called on behalf of the council), but as a matter of inescapable logic. I am quite unable to accept it. The council see fit to operate these systems and to pay for their operation, just as, some 10 or 15 years before the material date, they had seen fit to have them installed as part of their housing developments and to pay for their installation. The heating and hot water supply is of obvious value to the tenants and long leaseholders, who pay, and can be expected to pay, for the benefit that it brings to them. If no such supply were available they would have to pay for some other means of providing the heating and hot water that they need in their homes. Leaving aside any contractual arrangements that exist between the council and its tenants and long leaseholders (and the evidence before me on this is scant) and the duty of the council under section 22(3) of the 1949 to make the charges cover the costs of operation, there is no reason to suppose that the hypothetical tenant of each DHS, though willing to pay for the cost of fuel and labour to operate the system, would be unwilling to pay any rent for its occupation. No doubt, in the hypothetical world, the council and any consortium of tenants that might be interested in operating the system would not increase the rent by bidding against each other (as in *Hodgkinson*), but the assumed negotiation is between a hypothetical tenant wishing to occupy the system so that it can give a supply of heating and hot water and a hypothetical landlord

seeking to extract from the tenant the maximum it would pay to realise that wish. The hypothesis requires it to be assumed that they would reach agreement. Whether the potential tenant was the council or a consortium of ratepayers or a third party operator, logic does not compel the conclusion that it would not pay more than a nominal amount to achieve the occupation that it wished to have. On the contrary, the circumstances I have referred to suggest that the ability to provide a supply that is both beneficial and of value to those receiving it is likely to be of substantial value to the prospective operator of the system.

30. The second matter is whether, leaving aside the issue of the stage 5 allowance, there is any reason for me to reject the only evidence of value that I have, that of Mr Head. I can see nothing inappropriate in the use of the contractor's basis, and indeed Mr Scrafton did not suggest that it was inappropriate. Nor is there any evidence before me to suggest that any of the components of those valuations are erroneous. As far as the stage 5 allowance is concerned, the third matter for me to consider, I see no justification on the material before me for making any such adjustment. Mr Head said that he could see no special reason for an adjustment. There is no evidence at all to support Mr Scrafton's contention that, because of their poverty, the council would not have been able to pay as rent the values suggested, and in any event it would seem to me that the ability of the council to pay would only become of potential relevance if such rent could not be recovered from those receiving the supply, and on this, similarly, there is no evidence.

31. If, contrary to my earlier conclusion, therefore, the DHSs fall to be included as hereditaments in the rating list, I am satisfied that they should be entered at the values contended for by the VO.

Conclusion

32. The appeal is dismissed. None of the hereditaments are in my judgment rateable and each of the entries should accordingly be deleted.

33. At the hearing I heard submissions on costs, and both parties agreed that, if I upheld the decision of the LVT or ordered the deletion of the entries, the respondent should have its costs, and, if I determined that the hereditaments should be entered in the list at the values contended for by the VO, he should receive his costs. I am minded to award the respondent its costs. However, I have thought it appropriate to set out my conclusion on the values at which the hereditaments should be assessed if, contrary to my decision, the hereditaments are rateable, and I have decided this matter in the VO's favour. This does not seem to me to be any reason for depriving the successful respondent of any part of its costs, but the submissions made by the parties did not cover this matter, and before making my determination I think it appropriate that an opportunity to make further submissions should be given. A letter relating to this accompanies this decision, which will only become final when the question of costs has been determined.

11 March 2005

George Bartlett QC, President

ADDENDUM ON COSTS

34. The parties have responded to my invitation to make further submissions on costs, and the appellant accepts that the respondent should have its costs. The order will be that the appellant must pay the respondent's costs of the appeal, such costs if not agreed to be the subject of a detailed assessment by the Registrar on the standard basis.

22 March 2005

George Bartlett QC, President