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**LEASEHOLD VALUATION TRIBUNAL
OF THE
MIDLAND RENT ASSESSMENT PANEL**

BIR/17UG/OLR/2008/0071

DECISION OF THE LEASEHOLD VALUATION TRIBUNAL

*ON AN APPLICATION UNDER SECTION 48
OF THE LEASEHOLD REFORM, HOUSING AND URBAN DEVELOPMENT ACT 1993*

Applicant: Mr C M Hall (executor of leaseholder)

Respondent: Mr R Hock (freeholder)

Subject property: 3 Osborne Court
Brookside Road
Breadsall
Derby DE21 5LF

Hearing: 28 July 2008

Appearances:

For the applicant: Mr E J Rutledge FRICS

For the respondent: Mr R Hock

Members of the LVT: Professor N P Gravells
Mr C Gell FRICS
Mr M Ryder

Date of determination:

30 JUL 2008

Introduction

- 1 This is a decision on an application under section 48 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the 1993 Act") for the determination of the premium payable in respect of the grant of a 90-year extension of the lease of 3 Osborne Court, Brookside Road, Derby DE21 5LF ("the subject property"), pursuant to Chapter II of Part I of the 1993 Act. The applicant is Mr C M Hall, executor of the late Norma C Hall, the leaseholder of the subject property.
- 2 The leaseholder held the subject property under a lease dated 30 June 1977 for a term of 99 years expiring on 29 June 2076 at a fixed ground rent of £20.00 per year. The respondent is Mr R Hock, the owner of the freehold reversion to the subject property.
- 3 On 1 October 2007 the applicant gave a tenant's notice to the respondent freeholder under section 42 of the 1993 Act claiming the right to acquire a new lease of the subject property under the 1993 Act; and on 4 December 2007 the respondent freeholder gave a counter-notice under section 45 admitting the right to a new lease. On 28 May 2008 the Leasehold Valuation Tribunal received the present application (dated 23 May 2008) from the applicant.

Subject property

- 4 The subject property is a first floor flat in Osborne Court, a small development of flats and maisonettes in the centre of Breadsall village. The accommodation comprises sitting room, kitchen, two bedrooms and bathroom/wc. There is an allocated car-parking space in the courtyard to the front of the property.
- 5 The leaseholder had installed gas-fired central heating.

Inspection and hearing

- 6 On 28 July 2008 the members of the Tribunal inspected the subject property (which is currently unoccupied) in the presence of Mr E J Rutledge, representing the applicant.
- 7 At the subsequent hearing the applicant was represented by Mr E J Rutledge FRICS, of Lawrence & Wightman. The respondent freeholder represented himself, although he relied in part on a valuation prepared by Mr J Walker FRICS, of Newton Fallowell.

Representations of the parties

- 8 The Tribunal had received written representations from the parties; and those representations together with the oral representations and evidence presented at the hearing are outlined below in the context of the determination.

Determination of the Tribunal

- 9 The Tribunal gave full consideration to the evidence and submissions made on behalf of the parties.
- 10 Unfortunately, the valuation prepared by Mr Walker on behalf of the respondent was of very limited assistance to the Tribunal. The narrative, which contained a

number of factual inaccuracies, suggested that Mr Walker had little experience of the operation and application of the 1993 Act; and it contained no detailed calculation to reflect the principles of the Act.

- 11 The Tribunal holds that the basis of valuation adopted by Mr Rutledge properly reflects the principles of the 1993 Act applicable in the present case.
- 12 For the purposes of the valuation, the following matters were agreed by the parties:
 - The unexpired term of the lease on the valuation date (1 October 2007) was 68.75 years.
 - The ground rent is £20.00 per year.
 - The marriage value is to be divided equally between the leaseholder and the freeholder.
- 13 It follows that the matters to be determined by the Tribunal are:
 - The value of the existing lease.
 - The value of the lease extended for a further 90 years.
 - The percentage figures to be adopted for (i) the capitalisation of the ground rent and (ii) the deferment rate to be applied to the value of the extended lease.
- 14 In the light of the limited scope of the expert evidence on behalf of the respondent, the Tribunal examined the figures in the calculation submitted by Mr Rutledge. The Tribunal considered whether those figures were open to challenge on their face or in the light of the oral evidence of Mr Rutledge and Mr Hock.

Value of the existing lease

- 15 As to the value of the existing lease Mr Rutledge stated that the lease of the subject property had been on the market since November 2006. Against an original asking price of £129,995, the applicant had received offers of £110,000 and £117,500 in early 2007; but both offers had been withdrawn. In July 2007 the asking price was reduced to £124,995; and in August 2007 the applicant received an offer of £100,000, which was rejected. The property remains on the market but there have been no further offers (although there have been some expressions of interest if and when the lease has been extended). Mr Rutledge referred to the sale of the lease of 5 Osborne Court in July 2006 at a price of £105,000. On the basis of this evidence, and applying a discount of £2,000 to reflect the statutory disregard of the tenant's improvements (the central heating), Mr Rutledge valued the existing lease at the date of valuation at £110,000.
- 16 Mr Hock submitted that the value of the existing lease was significantly greater; but his submission was largely based on general statements as to property values in Breadsall. He did submit that 5 Osborne Court was not directly comparable to the subject property; and the Tribunal accepted his evidence that it is rather smaller than the subject property and that the sale of the lease in July 2006 was not an open market sale. In conclusion, Mr Hock expressed the view that the value of the existing lease of the subject property at the date of valuation was £130,000.
- 17 There is clearly an absence of conclusive evidence on the value of the existing lease. However, although the sale price of the lease of 5 Osborne Court is not directly relevant, that sale price suggests a value of the existing lease of the

subject property in the region of £110,000 in July 2006. Property prices continued to rise over the following twelve months; and, although there has been a significant fall in prices in the last twelve months, prices in October 2007 were still above their mid-2006 levels. Accordingly, the Tribunal determines the value of the existing lease of the subject property at the date of valuation at £115,000.

Value of the extended lease

- 18 In the absence of evidence of open market sales of extended leases of properties similar to the subject property, Mr Rutledge sought to value the extended lease by the application of a percentage uplift to the existing lease value. He put in evidence a large number of negotiated settlements for lease extensions; and he submitted that, in relation to an unexpired term of 68.75 years, the evidence suggested a figure for the uplift of 5 per cent. Accordingly, Mr Rutledge valued the extended lease at the date of valuation at £115,500.
- 19 Mr Hock did not express any views on a percentage figure for the uplift; but he expressed the view that the value of the extended lease at the date of valuation would be £150,000. As matter of arithmetic, that figure represents an uplift on his suggested existing lease value of more than 15 per cent.
- 20 In the absence of evidence of open market sales of extended leases, the Tribunal accepts that the value of the extended lease must be determined by the application of a percentage uplift to the value of the existing lease. Although the figure of 5 per cent adopted by Mr Rutledge is within the usual range applied to an existing lease with an unexpired term in the region of 70 years (whereas the respondent's arithmetical figure of 15 per cent is not), it is towards the lower end of that range and lower than has been adopted in recent decisions of the Tribunal. The Tribunal therefore determines that a slightly higher percentage figure should be adopted in the present case. Applying a figure of 6 per cent to the existing lease value of £115,000, and rounding up the resultant figure, the Tribunal determines the value of the extended lease of the subject property at the date of valuation at £122,000.

Capitalisation rate

- 21 In the absence of any argument on behalf of the respondent the Tribunal accepts the figure of 6 per cent adopted by Mr Rutledge for the capitalisation of the ground rent.

Deferment rate

- 22 On behalf of the applicant, Mr Rutledge's preferred calculation adopted a deferment rate of 6.5 per cent to be applied to the value of the extended lease. However, he stated that he would not be surprised if the Tribunal adopted the generic rate of 5 per cent determined by the Lands Tribunal in *Earl Cadogan and Cadogan Estates Ltd v Sportelli and Sportelli* ([2006] LRA/50/2005) and the other cases determined with that decision ("the *Sportelli* cases").
- 23 On behalf of the respondent, Mr Walker's valuation referred to "a flat rate of 6 per cent"; but, for the reasons indicated above, the Tribunal is unable to attach significant weight to Mr Walker's valuation.
- 24 The starting point for the determination of the deferment rate is the decision in the *Sportelli* cases. The Lands Tribunal heard extensive evidence from both financial experts and valuers; and it concluded that the deferment rate was reflected in the formula:

Deferment rate = risk-free rate – real growth rate + risk premium

where the risk-free rate is the return demanded by investors for holding an asset with no risk, the real growth rate is the *assumed* real growth rate for the long-term future and the risk premium is the additional return required by investors to compensate for the risk of not receiving a guaranteed return. The Lands Tribunal further concluded that the appropriate figures for the three elements of the deferment rate were 2.25 per cent for the risk-free rate, 2 per cent for the real growth rate and 4.5 per cent for the risk premium for house and 4.75 per cent for the risk premium for flats (to reflect the greater complexities of management in the case of flats).

The deferment rate for flats was therefore determined at 5 per cent.

- 25 Although the subject properties in the *Sportelli* cases were located in prime central London (PCL), the Lands Tribunal expressed the view that its decision provided strong guidance in cases concerning properties not only in other parts of London but also elsewhere in the country. It stated at paragraphs 122-123 of its decision:

"In our judgment the deferment rate may be treated as stable over time unless a trend movement in the risk-free rate can be identified or it can be established that the long term prospects of growth in residential property have changed or that, for some other reason, the attraction of investment in residential reversions can be shown to have increased or diminished.

The application of the deferment rate of 5 per cent for flats and 4.75 per cent for houses that we have found to be generally applicable will need to be considered in relation to the facts of each individual case. Before applying a rate that is different from this, however, a valuer or an LVT should be satisfied that there are particular features that fall outside the matters that are reflected in the vacant possession value of the house or flat or in the deferment rate itself and can be shown to make a departure from the rate appropriate."

- 26 The decision in the *Sportelli* cases was appealed to the Court of Appeal. The Court ([2007] EWCA Civ 1042) rejected the appeal (thereby upholding the Lands Tribunal's deferment rate figures). However, it went on to consider the status of the Lands Tribunal's decision as a precedent for Leasehold Valuation Tribunals in other cases. For present purposes, it is only necessary to refer to the remarks of Carnwath LJ relating to properties outside PCL. At paragraphs 100-102 of the judgment, he stated:

"The cases before the [LVTs] related entirely to properties within the PCL, and the evidence was directed principally to the market within that area. It seems that the [Lands Tribunal] of its own motion invited the experts to say whether the deferment rate would vary with location (paragraph 86). A variety of views was offered....

The [Lands Tribunal] concluded (at paragraph 88):

'While we accept the view of the valuers that the deferment rate could require adjustment for location, *on the evidence before us* we see no justification for making any adjustment to reflect regional or local considerations either generally or in relation to the particular cases before us. The evidence of the financial experts suggests that no adjustment to the real growth rate is appropriate given the long-term basis of the deferment rate, and locational differences of a local nature are, in the absence of clear evidence suggesting otherwise, to be assumed to be properly reflected in the freehold vacant possession value.' (My emphasis.)

The [Lands Tribunal's] later comments on the significance of their guidance do not distinguish in terms between the PCL area and other parts of London or the country. However, there must in my view be an implicit distinction. The issues within the PCL

were fully examined in a fully contested dispute between directly interested parties. The same cannot be said in respect of other areas. The judgment that the same deferment rate should apply outside the PCL area was made, and could only be made, on the evidence then available. That must leave the way open to the possibility of further evidence being called by other parties in other cases directly concerned with different areas. The deferment rate adopted by the [Lands Tribunal] will no doubt be the starting point; and their conclusions on the methodology, including the limitations of market evidence, are likely to remain valid. However, it is possible to envisage other evidence being called, for example, on issues relevant to the risk premium for residential property in different areas. That will be a matter for those advising future parties, and for the [LVTs], to consider as such issues arise."

- 27 The deferment rate in relation to properties outside PCL was the subject of extensive argument before the Leasehold Valuation Tribunal in *Zuckerman and others v Trustees of the Calthorpe Edgbaston Estate* ("the *Kelton Court* cases") (BIR/00CN/OLR/2008/0013). In those cases Mr Rutledge gave expert evidence in support of the adoption of a figure of 6.5 per cent for properties in the (West) Midlands. Specifically, he addressed the components of the risk premium identified by the Lands Tribunal in the *Sportelli* cases – concern on the part of the investor that the real growth rate might not be achieved (see paragraph 72), volatility, illiquidity, deterioration and obsolescence (see paragraph 75). He also challenged the 0.25 per cent differential between houses and flats (see paragraph 95-96).
- 28 At the end of the day the Tribunal was not persuaded that Mr Rutledge had discharged the evidential burden required if the Tribunal was to depart from the generic deferment rate determined by the Lands Tribunal in the *Sportelli* cases and endorsed by the Court of Appeal.
- 29 The decision of the Leasehold Valuation Tribunal in the *Kelton Court* cases has been appealed to the Lands Tribunal. Nonetheless, in the present case Mr Rutledge was content briefly to summarise his principal arguments in those cases.
- 30 In the circumstances, the Tribunal is not persuaded that it should reach a conclusion different from that in the *Kelton Court* cases; and it therefore determines that the appropriate deferment rate to be applied in calculating the premium payable for the extended lease of the subject property is 5 per cent.
- 31 Applying the figures agreed by the parties and those determined by the Tribunal, the Tribunal calculates the premium payable as follows:

(i) *Diminution in the freeholder's interest*

Term:

Ground rent: £20.00 per year
 Years Purchase: 68.75 years @ 6% = 16.363125
 £20.00 x 16.363125 = £327.26

Reversion:

Open market value with extended lease: £122,000
 (excluding tenant's improvements)

PV £1 in 68.75 years @ 5%: 0.0349408
 £122,000 x 0.0349408 = £4,262.78

£4,262.78
 £4,590.04

(ii) *Marriage value*

Open market value with extended lease: (excluding tenant's improvements)	£122,000.00
Less Freehold interest: £4,590.04	
Leasehold interest: <u>£115,000.00</u>	
£119,590.04	<u>£119,590.04</u>
	£2,409.96

(iii) *Premium payable*

Freehold interest:	£4,590.04
Marriage value (£2,409.96) x 50% =	<u>£1,204.98</u>
(say)	£5,795.00

Summary

- 32 The premium payable by the applicant in respect of the grant of a 90-year extension of the lease of the subject property is £5,795.

Nigel P Gravells

Professor Nigel P Gravells
Chairman