LRA/79/2006
& LRA/4/2007

LANDS TRIBUNAL ACT 1949

LEASEHOLD ENFRANCHISEMENT – hope value – marriage value – preliminary issue – valuation under Leasehold Reform Act 1967 s 9(1A) and (1C) – whether value of landlord's interest can include hope value* – Sportelli v Cadogan considered –** ***held hope value not to be included – 1967 Act s 9(1D)

IN THE MATTER OF APPEALS AGAINST DECISIONS OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE LONDON RENT ASSESSMENT PANEL

BETWEEN **STEPHEN L PITTS and YUE WANG** **Appellants**

and

EARL CADOGAN **Respondent**

Re: 35 Hans Place, London SW1X OVZ
(LRA/79/2006)

EARL CADOGAN **Appellant**

and

ATLANTIC TELECASTERS LIMITED **Respondent**

Re: 10 Holbein Mews, London SW1W 8NN
(LRA/4/2007)

Before: The President

Sitting at Procession House, 110 New Bridge Street, London EC4V 6JL
on 3 May 2007

Andrew Walker instructed by Bircham Dyson Bell for the appellants Mr Pitts and Ms Wang
Philip Rainey instructed by Pemberton Greenish for Earl Cadogan
Edwin Johnson QC instructed by Terence St J Millett for Atlantic Telecasters Ltd

The following cases are referred to in this decision:

Cadogan v Sportelli [2006] RVR 382
Pitts and Wang v Cadogan Preliminary Issues (1) (LRA/79/2006, 28 March 2007, unreported)
Arbib v Cadogan [2005] EGLR 139
Lloyd Jones v Church Commissioners (1981) 261 EG 471
Norfolk v Trinity College, Cambridge (1976) 32 P&CR 147
Lowther v Strandberg [1985] 1 EGLR 203

The following further cases were referred to in argument:

Custins v Hearts of Oak Building Society (1969) 209 EG 239
Haw v Peek (1969) 210 EG 347
Wellcome Trust Ltd v Cecil Properties Ltd (LON/LVT/2068/06, unreported)

DECISION ON A PRELIMINARY ISSUE

1. These are two appeals, by the tenants in one case and by the landlord in the other, from decisions of leasehold valuation tribunals on applications to determine the price payable in each case for a house on the Cadogan Estate under section 9(1A) and (1C) of the Leasehold Reform Act 1967. In relation to the first appeal, which concerns 35 Hans Place, on 28 March 2007 I determined on a preliminary issue that it was open to the landlord to contend that an allowance should be made for hope value. On 12 April 2007 I ordered in relation to each appeal that the following should be determined as a preliminary issue:

> "Whether the appellant is prevented as a matter of law from contending for hope value as an element in the value of the landlord's interest."

This is the decision on the issue.

2. The value of a landlord's interest on any leasehold enfranchisement valuation is acknowledged to contain two primary elements – the value of the right to receive the ground rent and the value of vacant possession at term. The ground rent is capitalised over the period of the unexpired term, and the value of the vacant possession at term is arrived at by applying to the current vacant possession value a deferment rate: see *Cadogan v Sportelli* [2006] RVR 382 at paragraph 2. In addition there is a potential third element, hope value, the subject of the present dispute. Hope value consists in the option that the freeholder has to sell the freehold or a lease extension to the tenant and thus realise the whole or part of the freeholder's share of such marriage value as exists at the date of the sale: see *Sportelli* at paragraph 98.

3. The enfranchisement price is derived by adding to the value of the freehold reversion the landlord's share of the marriage value. The marriage value is the uplift that is realised by marrying the freehold and leasehold interests. It is the difference between the sum of the values of those interests and the freehold vacant possession value. In valuing the freehold reversion before the LVT the landlord's valuer on the first appeal, Mr K D Gibbs FRICS, took account of hope value in his valuation by treating it as a factor that was material to the deferment rate: see my decision in *Pitts and Wang v Cadogan* Preliminary Issues (1), paragraph 4. The LVT did not make any reference to hope value in its decision, but it may have taken it into account in reaching its decision: ibid paragraph 5. In the second appeal, the landlord's valuer before the LVT, Mr R Cullum FRICS, allowed for hope value in his valuation, but in a different way from Mr Gibbs. Having established the value of the freehold reversion by capitalising the ground rent and deferring to the term date the current vacant possession value, he added together the values of the freehold and leasehold interests and deducted the result from the value of the freehold with vacant possession. The difference he termed the "latent value", and he added 20% of this "in anticipation of early deal" (ie as hope value) to the value of the freehold reversion.

4. In a fully reasoned decision the LVT rejected Mr Cullum's hope value addition. Its conclusion was this:

> "The requirement under section 9(1A) is to arrive at the price which would be realised in the open market at the valuation date. There can be only one value at this date which, if the tenant is in the market, will include marriage value. There is no requirement to assess the freehold value and the marriage value separately as is provided under Schedule 6 of the 1993 Act. Both parties have included marriage value in their valuations, which is an acceptance that the tenant is in the market and will offer the best price. The freehold value, including hope value, contended for by Mr Cullum, is a value, which may apply at some date before the tenant is in the market for the freehold interest, and is quite irrelevant once it is accepted that the tenant is in the market. The hope value is subsumed into the full marriage value reflected in the value of the interest at the valuation date. It would also effectively increase the landlord's share of the marriage value to more than the 50% share to which he is statutorily entitled under the 2002 Act.
>
> Looked at from the tenant's point of view, he is purchasing the landlord's freehold interest here and now, so why should he also now be expected to pay an additional sum of more than £60,000 to the landlord on the grounds that he might have wished to enfranchise at a later date if he was not doing so now."

5. The issue of hope value has featured in the two major deferment rate decisions of this Tribunal in the last two years, *Arbib v Cadogan* [2005] EGLR 139 and *Sportelli*. In *Arbib* the Tribunal (Judge Rich QC and P H Clarke FRICS) allowed for hope value by taking account of it in the deferment rate: see *Sportelli* at paragraph 7. In *Sportelli* the issue was clearly defined and was directly addressed in the decision. The Tribunal (George Bartlett QC, President, His Honour Michael Rich QC and P R Francis FRICS) had before it appeals in five enfranchisement applications. Three were for the collective enfranchisement of flats, one was for the lease extension of a flat, and one was for the enfranchisement of a house (13 South Terrace). The Tribunal held that, with the exception of the house, hope value was to be excluded from the valuations: see paragraph 108.

6. The Tribunal's conclusion on hope value in *Sportelli* was derived from a consideration of the particular statutory provisions that applied to the different types of enfranchisement. It noted the exclusion of the tenant as a bidder in the case of low-value houses, where the price falls to be determined under section 9(1) of the 1967 Act. That provision, as amended by the Housing Act 1969, provides:

> "....the price payable .... shall be the amount which at the relevant time the house and premises, if sold in the open market by a willing seller with the tenant and members of his family not buying or seeking to buy might be expected to realise....."

At paragraph 102 the Tribunal concluded that the exclusion of the tenant's bid applied not only at the relevant time but also at any future time and applied not merely to "seeking to buy" the freehold but also to seeking to buy any such interest as would have the effect of including in the valuation the special value to the tenant. Hope value was thus excluded. In the case of collective enfranchisements under Chapter I of Part I of the 1993 Act or new leases of flats under Chapter II the Tribunal held that the words excluding particular persons as bidders in paragraph 3 of Schedule 6 and paragraph 3(2) of Schedule 13 were so manifestly derived from

section 9(1) of the 1969 Act as amended that it seemed inescapable that the same effect was to be given to them (paragraph 104). Hope value was thus held to be excluded in the three collective enfranchisement cases and in the case of the lease extension of the flat.

7. At paragraph 103 the Tribunal contrasted these provisions with section 9(1A) of the 1967 Act (saying, incorrectly, that it had been inserted by the 1993 Act: the insertion had in fact been made by the Housing Act 1974). That provision does not contain any exclusion of the tenant's bid. The Tribunal said, therefore, that, although hope value was excluded in four of the five cases, it fell to be evaluated in relation to the house, 13 South Terrace (paragraph 108). It concluded (paragraph 112) that for the purpose of allowing for hope value it was appropriate to apply a lump sum to the reversion prior to the marriage value apportionment.

8. There was no respondent to the appeal relating to 13 South Terrace (*Bircham & Co (Nominees)(No.2) v Clarke* (LRA/63/2005)), and on 9 November 2006 the Tribunal (P R Francis FRICS), on the basis of written representations from the landlord, gave the final decision upon it in the light of the *Sportelli* determination. The Member said that he saw no reason not to accept the quantification of Mr Cullum (the landlord's valuer) of a 20% addition to the reversion value prior to the statutory marriage value apportionment, and he adopted Mr Cullum's valuation.

9. Despite the decisions in *Sportelli* and 13 South Terrace, LVTs, I was told, have subsequently refused to include anything for hope value when determining enfranchisement prices under section 9(1A) and 9(1C), on the basis that no such addition could ever properly fall to be made. The present appeal in relation to 10 Holbein Mews is one of those cases.

Statutory provisions

10. So far as material, section 9(1A) provides as follows:

> ".... the price payable .... shall be the amount which at the relevant time the house and premises, if sold in the open market by a willing seller, might be expected to realise on the following assumptions:-
>
> (a) on the assumption that the vendor was selling for an estate in fee simple, subject to the tenancy, but on the assumption that this Part of this Act conferred no right to acquire the freehold or an extended lease. ...."

Also of relevance are subsections (1D) and (1E):

> "(1D) Where, in determining the price payable for a house and premises in accordance with this section, there falls to be taken into account any marriage value arising by virtue of the coalescence of the freehold and leasehold interests, the share of the marriage value to which the tenant is to be regarded as being entitled shall be one-half of it.

(1E) But where at the relevant time the unexpired term of the tenant's tenancy exceeds eighty years, the marriage value shall be taken to be nil."

Submissions

11. For the tenant in the second appeal Mr Edwin Johnson QC submitted that the LVT's decision was correct on the hope value point and was correct for the reasons that it gave. The reason why hope value was excluded as a matter of law from a section 9(1A) valuation was very simple. Section 9(1A) was introduced by the Housing Act 1974. The Housing Act 1974 increased the then rateable value limits under the 1967 Act, thereby permitting the enfranchisement of certain higher value properties. In exchange for this increase in the rateable value limits, the valuation regime in section 9(1A) was introduced, as a regime more favourable to the landlord than section 9(1). One of the ways in which a section 9(1A) valuation was made more favourable to the landlord was by the deletion of the words that appear in section 9(1) excluding the tenant and his family as potential buyers. Thus the sitting tenant was included in the hypothetical market for the freehold reversion. The consequence of the tenant being included in the market, Mr Johnson said, was that he would pay, over and above the rest of the market, a price that included a share of the marriage value. But a tenant would not pay hope value, which was a value that only existed for a third party purchaser, who anticipated the prospect of a deal with the tenant. A tenant would not pay marriage value and hope value since marriage value was the realisation of hope value. To include hope value in a section 9(1A) valuation was thus blatant double-counting, with the tenant ending up by paying 60% of the marriage value rather than the 50% prescribed by section 9(1D).

12. Mr Walker for the tenants in the first appeal adopted Mr Johnson's arguments and advanced further contentions to the same effect. For the landlord in both appeals Mr Rainey submitted that the landlord's option to deal was part of the value of the freehold interest and should be taken into account before marriage value was calculated. Marriage value was the conventional method of calculating the tenant's overbid. There was nothing wrong in principle in including hope value in the freehold reversionary value because it was a value that belonged to the landlord already. Indeed it would be perverse and wrong to exclude that value. Marriage value was the additional value unlocked by the coalescence of the leasehold and freehold interests. The question was, additional to what? To which the answer was, to what the freehold and leasehold interests together would otherwise be worth. Marriage value did not include hope value, because hope value was part of the value of the freehold interest before marriage value was calculated. There was no double-counting as argued by the tenants. Mr Rainey said that section 9(1D) did not purport to spell out what marriage value was, and it was not implicit that hope value was excluded.

13. It had always been the case, Mr Rainey said, that section 9(1A) valuations included hope value. Such inclusion had been unsuccessfully challenged in *Lloyd Jones v Church Commissioners* (1981) 261 EG 471, and it was inferable that it had been included in the first section 9(1A) case, *Norfolk v Trinity College, Cambridge* (1976) 32 P&CR 147 since both the landlord's valuer and the Tribunal Member were the same in each case. *Lowther v Strandberg* [1985] 1 EGLR 203, in which the same Member at 205 col 1 referred to the value of landlord's

interest as being "the amount which the freeholder would obtain elsewhere in the market" was consistent with this. In *Arbib* hope value was plainly included within the deferment rate in the section 9(1C) valuation of 40 Chelsea Square, and it was expressly included in *Sportelli* in the case of 13 South Terrace.

Conclusions

14. The issue to be determined is a question of law: whether the appellant is prevented as a matter of law from contending for hope value as an element in the value of the landlord's interest. The issue becomes a question of law, in my judgment, because of section 9(1D). The difference between the parties in the present cases is as to what constitutes "marriage value" and how it is to be calculated in the light of any hope value that there may be. In the absence of section 9(1D), which I will come on to later, no question, it seems to me, could arise as a matter of law as to what constitutes marriage value and whether the value of the landlord's interest can include hope value. Subsection (1A) leaves it entirely at large how "the amount which…the house and premises…might be expected to realise on the [prescribed] assumptions" is to be arrived at as a process of valuation. If that subsection stood alone there would be no obvious constraint on the method of valuation or on what should be treated as constituting marriage value (if that formed an element in the valuation method), how it should be determined or how it should be divided between the parties. These could all be the subject of evidence and of legitimate disagreement between valuers. The two valuation approaches advanced by the parties in the present cases would in my view, certainly in the absence of subsection (1D), be lawful, in the sense that they would not offend any of the statutory provisions, and would fall to be assessed in the light of evidence and argument.

15. Each of the valuation approaches seeks to take account of the fact that, in the open market, the tenant would (or could) be a special purchaser, willing to pay more for the freehold interest than any other purchaser because the conjoined freehold and leasehold interests would be worth more than the sum of their respective values when separately owned. The landlord's approach starts by determining what the freehold and leasehold interests would sell for in the open market, with the tenant excluded as a potential purchaser of the freehold interest. Included in the value of the landlord's interest is hope value. There are then attributed to the landlord on the one hand and the tenant on the other proportions of the difference between the sum of the value of the freehold and leasehold interests and the value of the freehold in possession. It is that difference that, in this, approach, is referred to as the marriage value.

16. There are two points to be noted in relation to this approach. The first is that hope value does not necessarily exclusively reside in the landlord's interest. If in the no-Act world a purchaser of the tenant's interest would pay a premium to reflect the potential for doing a deal with the landlord at some point in the future to acquire the freehold, this would fall to be reflected in the valuation of that interest. The second point is that, in the hypothetical negotiations on how the marriage value is to be divided, it seems at least possible that each of the parties would take into account the amount of any hope value that was included in each of the interests since hope value and marriage value together would constitute the difference

between the sum of the values of the interests, shorn of all considerations as to their conjunction, and the freehold vacant possession value. I will return to this later.

17. The tenants' valuation approach is to value the freehold and leasehold interests leaving out of account entirely all prospect of their union. What then falls to be divided is the marriage value of the interests valued on this basis. It is a marriage value arrived at on a different basis from that in the landlord's approach. In the absence of any statutory provision affecting the matter each of these marriage values could equally legitimately be referred to as the marriage value. It is, however, this qualification – "in the absence of any statutory provision affecting the matter" – that is in my judgment crucial. There is now a statutory provision relating to marriage value, in section 9(1D), inserted by the Commonhold and Leasehold Reform Act 2004, that has to be taken into account. In providing that the tenant's share of the marriage value arising by virtue of the coalescence of the freehold and leasehold interests shall be one-half it requires, inescapably in my view, a determination of the nature of the marriage value that is being referred to. Is it the marriage value derived on the landlord's approach or one derived on the tenants' approach?

18. It seems to me inherently more likely that in prescribing a 50-50 split of the marriage value the provision must be taken as referring to a marriage value derived from a valuation of the freehold and leasehold interests that leaves out of account entirely the prospect of their coalescence. I can see that if at the time the 2004 Act was enacted there had been a clear practice of deriving the marriage value on the basis of the landlord's approach this would have been a strong pointer the other way. But, despite Mr Rainey's assertion that section 9(1A) valuations have always included the value of the option to deal within the value of the freehold reversion, there appears to be nothing to support it.

19. Mr Rainey, as I have said, relies for his assertion on the decision of this Tribunal (W H Rees FRICS) in *Lloyds Jones v Church Commissioners for England*. The Member accepted "in its entirety" the valuation of the landlord's valuer, Mr M St J Hopper FRICS (see (1981) 261 EG 471 at 474 col 2). The valuation, which is set out in 472 col 2, refers to "Value of lessors' interest excluding prospects of 'marriage'" and "Value of lessee's interest excluding prospects of 'marriage'". Exclusion of the prospects of marriage would certainly appear to suggest that hope value was not included in the value of the landlord's interest. But Mr Rainey points to passages at 473 col 1 where it is recorded that Mr Hopper said in cross-examination that his Stage A valuation of the landlord's interest "allows a deal with the occupier at some future date on some terms or other"; and that counsel for the landlord, Mr Michael Barnes QC, submitted that in the real market, if the freehold subject to the lease were to be offered for sale and the lessee were not interested in purchasing, the possibility that he or his successor in title might later on wish to buy would be a factor affecting the bid of potential purchasers, and referred to this as "hope value" in contrast to the actual realisation of marriage value, which came in at Mr Hopper's stage B. I find it impossible to derive from these passages any clear indication that Mr Hopper's valuation, despite apparently expressly valuing the landlord's interest leaving out of account the prospect of marriage, did nevertheless include something for hope value or that the Tribunal accepted that hope value should be included. Mr Barnes's articulation of the matter appears to have been directed to dealing with a point made by Mr Nigel Hague QC for the tenant and in any event it could scarcely assist in establishing what

Mr Hopper had in mind. *Lowther v Strandberg*, on which Mr Rainey also relied, contains no reference to hope value, and there is nothing to suggest that it was included in any of the valuations. Apart from *Lloyd Jones*, therefore, there is nothing that Mr Rainey is able to point to in order to show that it was the practice to include hope value as part of the landlord's interest, and I accept Mr Johnson's submission that no such valuation practice has been shown.

20. In prescribing a 50-50 split of marriage value it is in my judgment more likely than not that the provision in section 9(1D) is to be taken as referring to a marriage value derived from a valuation of the freehold and leasehold interests that leaves out of account entirely the possibility of their coalescence. Mr Cullum derived his hope value from such a marriage value (although he called it "latent value" to distinguish it from the marriage value that he reached after valuing the landlord's interest with hope value included). The amount of hope value derived in this way is clearly extremely judgmental, while hope value included as an element in the deferment rate (see *Arbib* at paragraph 7) would be indeterminate. The judgmental nature of the amount of hope value to be assumed might not matter if, in the hypothetical negotiation, the parties were free to agree a division of the marriage value that could have regard to this. But the statute provides for a 50-50 split, and this suggests, since there was no established valuation practice in relation to hope value, that it envisaged a marriage value derived without regard to hope value. It would certainly be an odd result if the provision, in seeking to give certainty by prescribing the split of marriage value, were to have the effect of encouraging valuation disputes on the speculative element of hope value.

21. It is for these reasons that I conclude that hope value cannot as a matter of law be included as an element in the valuation of the landlord's interest. I do not think that the issue is to be decided on the basis that to include hope value would result in double counting, for that is to beg the question. Mr Walker's contention, which was adopted by Mr Johnson, was that to include 20% hope value in the value of the landlord's interest, with this being split 50-50 as prescribed, would result in the landlord getting 60% rather than 50% of the marriage value. But that is to make an assumption on the very matter in dispute – whether the marriage value referred to in section 9(1D) is or is not one derived from a valuation of the interests of the landlord and tenant that excludes hope value.

22. The decision in *Sportelli* in relation to 13 South Terrace that hope value was properly included in the valuation of the landlord's interest was reached in the absence of any contention that such inclusion was wrong in law. The appeal on 13 South Terrace was not contested. In the present hearing I have had the benefit of full and careful argument on the point on both sides, and I am satisfied that the decision of the LVT in the second appeal was correct, albeit not for the reasons that it gave. The decision on the point in *Sportelli* should be regarded as having been given per incuriam. I would add, however, that I can see no inconsistency between my decision in the present cases and the decision in *Sportelli* in relation to hope value in valuations under the 1993 Act.

Dated 21 May 2007

George Bartlett QC, President