FIRST-TIER TRIBUNAL
PROPERTY CHAMBER (RESIDENTIAL PROPERTY)

Case References	**:**	**CHI/29UN/OLR/2019/0013** **CHI/29UN/OLR/2019/0004** **CHI/43UG/OLR/2019/0008** **CHI/43UG/OLR/2019/0009** **CHI/43UG/OLR/2019/0010** **CHI/43UG/OLR/2019/0011** **CHI/43UG/OLR/2019/0012**
Properties	**:**	**3 and 41 Observatory Way Ramsgate CT12 6AZ** **24, 36, 54, 60 and 86 Pretoria Road Chertsey Surrey KT16 9AZ**
Applicants	**:**	**Mr K W Melluish (flat 3 Observatory)** **Seabreeze Corporation (flat 41 Observatory)** **Mr P A Stubbs (flat 24 Pretoria)** **Mr B Robinson & M L Fagan (flat 36 Pretoria)** **Ms R M Ali (flat 54 Pretoria)** **Ms H D Hill (flat 60 Pretoria)** **Ms L R Merrall (flat 86 Pretoria)**
Representatives	**:**	**Griffin Smith LLP** **Mr R Kaye MSc MRICS** **Ms Heman of Counsel (Pretoria only)**
Respondents	**:**	**Elmbirch Properties plc (1)** **New Meridian Village Management Company Ltd (2) (Observatory Way)** **Fusion (Chertsey) Management Company Ltd (Pretoria Road)**
Representatives	**:**	**Bonallack Bishop** **Mr M Buckpitt of Counsel (Observatory Way)** **Mr P Harrison of Counsel (Pretoria Road)**
Type of Application	**:**	**S48 Leasehold Reform Housing and Urban Development Act 1993**

Tribunal Members	**:**	**Judge F J Silverman LLM** **Mr R Athow FRICS** **Mr L Jarero FRICS (Pretoria Road only)**
Date and venue of hearing	**:**	**30 April 2019** **Margate Magistrates Court** **18 & 19 June 2019** **10 Alfred Place London WC1E 7LR**
Date of Decision	**:**	**25 June 2019**

DECISION

The Tribunal determines that the capitalisation rate to be applied to each of the subject properties in this application shall be 6.15%.

REASONS

1 The Applicants from the flats in Observatory Way (Observatory) and Pretoria Road (Pretoria) made separate applications to the Tribunal on 12 December 2018 asking the Tribunal for a determination under s48 Leasehold Reform Housing and Urban Development Act 1993 (terms of acquisition of a lease extension on a flat).

2 Directions were issued in all of the cases on or around 9 January 2019.

3 The Observatory cases were listed to be heard together on 30 April 2019.

4 Following an inspection of the Observatory properties (external only of flat 41) on the morning of 30 April 2019, the hearing of that matter commenced at Margate Magistrates court where Mr Kaye represented the Observatory Applicants and Mr Buckpitt of Counsel appeared for the Respondents.

5 As there was insufficient time to conclude the evidence on that day the Tribunal adjourned the hearing to a further date to be arranged.

6 The Applications relating to Pretoria Road were due to be heard shortly afterwards by a different Tribunal but in the light of the adjournment of the Observatory Way cases it was considered convenient to link them with the Pretoria Road applications and to ask the same Tribunal to deal with both sets of applications. The point in issue between the parties is identical in each of the cases under consideration. All the Applicants share the same representatives and all the Respondents are effectively part of the same group of companies. The same surveyors are acting as experts for the Applicants/ Respondents respectively in all of the cases and the factual background of each of the cases is very similar.

7 That being so, all of the cases were re-listed to be heard/continued on 18 and 19 June 2019 in London with Mr Jarero joining the Tribunal in respect of the Pretoria Road cases but not the Observatory Way cases where some evidence had already been heard on the previous hearing day.

8 As noted above, the Tribunal had inspected the Observatory Way properties on 30 April 2019 but were only able to gain access to the interior of no 3. Both flats are of recent construction on a large estate of mixed houses and flats on the outskirts of Ramsgate. Flat 3, situated on the first floor of a small block of flats was accessed via an internal staircase and comprised a small hallway, two small double bedrooms, one with an en suite bathroom, a further bathroom with full bath and a combined kitchen/living room with fitted appliances including a dishwasher. Both the flat and the common parts were in good structural and decorative order. The flat had no outside space but did benefit from a parking space. It is understood that the interior of Flat 41 was similar to Flat 3.

9 At the date of the resumed hearing the Tribunal had not inspected the Pretoria Road properties but had seen a number of photographs of the exterior and interior of the subject properties from which it appeared that the Pretoria flats were broadly similar to those in Observatory Way. Counsel for all parties agreed that the Pretoria Road estate was slightly more contemporary in design than Observatory Way, and was in a more upmarket location. The individual flats were marginally larger but the spec was almost identical. Given the limited issue(s) in this case they did not feel it was necessary for the Tribunal to inspect Pretoria Road.

10 In relation to all Pretoria properties the parties' representatives had agreed the following matters (page 389):

- Valuation date: 26 July 2018
- Remaining lease term: 114.44 years
- Current rent :£520 pa (except no 60 : £460pa)
- Deferment Rate :5%
- Freehold vacant possession value : £318,180 (except no 60: £246,480).

11 Similarly, for Observatory Way:

- Valuation date: 26 July 2018
- Remaining lease term: 114.44 years
- Current rent : £360pa
- Deferment Rate : 5%
- Freehold vacant possession value : £146,460.

12 In all cases the only matter which the Tribunal was asked to determine was the capitalisation rate (cap rate) to be applied to the ground rent. It was agreed that the same rate would be applicable to all the subject properties.

13 The calculation of what should normally be a straightforward issue was in all the cases under discussion affected by a single factor which has recently emerged in the leasehold market and in respect of which very little comparative evidence currently exists either in the form of transactions or by reference to other Tribunal or higher court decisions.

14 The problematic factor is the presence in the respective leases of high initial ground rents coupled with rent review provisions which double the ground rent at regular intervals of ten 15 or 20 years. Some of these clauses operate over the entire length of the lease term, others are capped at between 40-60 years and some revert to a review based on RPI at the end of the fixed

review period. In the present case all the leases contain provisions for 10 yearly fixed rent reviews which double the ground rent at each review up to and including the fiftieth year after which the reviews revert to assessment by reference to RPI.

15 For the Respondent landlords it has been argued that the presence of the escalating rent clauses enhances the value of their investment whereas the Applicant tenant's perspective is that the value of a leasehold is diminished by the high ground rent provisions which can make the property difficult to sell or mortgage.

16 It is known that the government proposes to take action to prohibit escalating ground rents in future and that one major construction company has set aside a large sum of money to compensate tenants who have leases with these high rent provisions and who meet the strict criteria of the scheme. The UK Finance Lenders' handbook (previously CML) also requires properties containing these provisions in the leases to be referred to the lender for approval suggesting that they may not in all cases be acceptable as security for a loan. A number of landlords, including the Respondents in this case, are offering terms to tenants to buy out the review clauses and replace them with more acceptable RPI provisions. None of these factors however can be taken into account in the present case because the Leasehold Reform Housing and Urban Development Act 1993 requires the matter to be considered as at the valuation date which was in this case a date prior to the announcement of the government's intentions to legislate. Secondly, and for the same reason, the valuation has to be carried out on the assumption of a 'no Act world' ie. the assumption that the 1993 Act does not exist and therefore the effect of its provisions cannot affect the value of the property either to enhance it or to detract from it.

17 The problem of the paucity of credible comparables was raised at the first day of this hearing (in Margate) and the parties' valuers were both asked by the Tribunal to carry out further research into comparable evidence and to prepare supplementary reports to be presented for the resumed hearing.

18 Although both valuers did present supplementary reports at the resumed hearing the Respondents' valuer was alone in having complied with the Tribunal's direction. He had written to colleagues who deal with similar estates/properties and asked them to report their experiences of recent transactions with similar property. Although the results of this search were small they did produce some additional evidence whereas the Applicant's valuer did not carry out this exercise at all. The further research by the Respondents' surveyor with its limited yield also served to corroborate his own evidence which was that to date, there had been very few live transactions on the open market.

19 Both parties agreed that Nicholson v Goff [2007]1 EGLR 83 laid down the factors relevant to the capitalisation rate. The Applicants' valuer was insistent that location was not a factor which was to be taken into account in applying the Nicholson v Goff principles. The Respondents' valuer disagreed with this. He said that although he had initially agreed with the Applicants' valuer's view, he had changed his view over the years and had come to the conclusion that investors were looking at the long term view and were influenced by both location and lease length. The Tribunal agrees with the Respondents' view and considers that the location of a property is integral to any factor relating to its value as is amply demonstrated by the difference in

market prices between the Observatory and Pretoria properties themselves which, apart from location, have strong similarities.

20 The Applicants' valuer did not disagree with the Respondents' valuer's assertion that the reversions in question were of a type which would be bulk bought by a specialist investor. The Respondents' valuer's experience was that these reversions would not normally be sold on the open market but would be offered discreetly to a small number of interested parties of whom the Respondents would be one. In the Respondents' valuer's opinion such properties would rarely be sold at auction and his only experience of auctions was one of difficult properties which owners wished to remove from their portfolios.

21 Both surveyors spoke to their evidence and explained their comparables to the Tribunal. Each party's valuer sought to justify his decision to set the capitalisation rate, Mr Kaye for the Applicants at 9.5% and Mr McKeown for the Respondents at 6.15%.

22 In the light of this large disparity in the rates between the two valuers the Tribunal chose to review the analysis of all the comparables when making their decision. The Tribunal's commentary on the comparables is set out below.

23 The order in which the comparables are dealt with below follows the summarised spreadsheet presented to the Tribunal by the Respondent at the resumed hearing.

23.1 **90 Pretoria Road** : cap rate 5.8%, date : January 2019

This transaction relates to a property on the same estate and similar to the Pretoria cases under discussion. It is of recent date (04 Jan 2019) but came about as a result of an agreement between the parties and without recourse to litigation. This was a case where a S42 notice had been served and was accepted by the landlord. The lease also had 4 x 15 year rent reviews which does not exactly match the 5 x 10 year reviews in the present case. The tenant had been represented by an experienced practitioner. It is therefore an interesting example to note but not one on which to place total reliance unless no better comparables can be found.

23.2 **Verona Apartments**: cap rate 6.30%, date November 2017

This example presented by the Respondents' valuer and subsequently commented on by the Applicants' valuer probably represents the closest comparable to the subject property in that it comprises the sale of a block of 132 recently built flats in Slough which have ten year doubling rent review provisions for the first forty years of the term reverting thereafter to RPI. The individual flats are similar in value to the subject properties. The transaction related to a sale of the entire reversionary interest and no evidence could be found of the sale of any individual unit.

23.3 **Ferrymead Gardens**: cap rate 5.9%, date March 2017.

Details of the sale of the reversionary interest in this purpose built block comprising 120 units at Ferrymead Gardens in Ruislip was brought to the Tribunal's attention as a result of Mr McKeown's search for additional evidence as directed by the Tribunal. The majority of the flat leases here contain ten year rent doubling clauses up to the fiftieth year (identical to the subject properties); again there is no evidence of transactions relating to individual units but it stands together with Verona Apartments as a credible comparable in terms of property type and location, lease terms and date of transaction.

23.4 **Old Church Court Salford**: cap rate 8.5%, date April 2018

Mr McKeown presented this property as part of his evidence but dismissed it as a suitable comparable because it deals only with 19 flats, its location is not comparable to the subject properties and it also differs in that the value of the individual flats is much lower (less than £100,000 per unit) and the rent review provisions are not consistent within the block, 14 units having 10 year doubling provisions and five with RPI clauses. The Tribunal agrees with Mr McKeown's analysis.

23.5 **Blythe Court**: cap rate not calculated , date February 2018

This block in a Birmingham suburb has been described as 'the worst example of leasehold abuse in the country ' (page 471). It is a block of 12 flats, most of which have doubling rent review clauses which render the individual units unsaleable, commonly described as 'toxic'. The reversion was sold at auction in February 2018. Although close in date to the subject transactions the Tribunal rejects this as a suitable comparable because the block is too small, the flats are smaller than those in the subject properties, its location is not comparable, the flat values are not comparable and it was a sale by auction not by private treaty.

23.6 **Kensington Road**: cap rate 12.25%, date May 2018

Despite its London sounding name this block of three flats in a converted Victorian house is situated in Morecambe near Blackpool. Mr Kaye for the Applicants asserted that this was a good comparable to the subject properties. The Tribunal does not agree with that conclusion. The location of the property is not remotely comparable to the subject properties, the property itself as a small converted unit bears no comparison to the large modern estates on which the subject properties are situated, the lease terms are different in that these flats have uncapped ten year reviews (ie for the entire length of the demise) and the individual unit values are estimated at less than £100,000 each.

23.7 **Plumstead Common**: cap rate 16%, date approx. autumn 2016

A comparable presented by Mr Kaye who agreed that he had reservations about it as a valid comparable. The Tribunal shares those reservations. The 'block' is a semi-detached house converted into three units, adjacent to a petrol station in south east London. The reversion was put to auction in 2016 but was sold prior to the auction itself for an unknown price. Apart from the unsuitability of the property itself (location, size, unit value) insufficient details exist for this property to be considered as a suitable comparable.

23.8 **Waldegrave Road**: cap rate 7.70%, date December 2017

This is another small block (five units) in south west London presented by the Applicants' valuer which was sold by auction. The value of the individual units, is around £1,000,000 which, irrespective of the effect of location, suggests that the flats are in a different league to the subject properties. They also have a non-comparable 20 year ground rent doubling provision and two unusual comments in the auction particulars which might affect the price achieved in the transaction. The first was that the tenants had chosen not to exercise their rights of first refusal under the 1987 Act and secondly that the landlord had no right to manage the property.

23.9 **Ladywell Point**: cap rate 8.11%, date September 2017

A large office block conversion in Manchester proposed as a comparable by the Applicants' valuer is considered by the Tribunal to be unsuitable on the grounds that the figures put forward by Mr Kaye arise not from any live transaction but from a book valuation of the reversioner's assets. It is therefore

not reliable and also does not bear comparison with the subject properties either as to location or type.

23.10 **Week St and St Georges Court**

Both of these properties were initially included in the Applicants' valuer's evidence but were subsequently agreed by both parties to be unsuitable and neither party placed any reliance on them. They are not further discussed here.

24 The Tribunal was also referred to the previous Tribunal decisions in St Martins Avenue (page 593) dated 3 March 2016 (LON/BB/OCE/2015/0180 & 0277) and Farringdon Court dated 4 June 2019 (CAM/00MC/OLR/2019/0020). The St Martins Avenue decision provided for a cap rate of 6% and Farringdon Court of 8.5%. St Martins Avenue related to a single unit in a converted Victorian terrace house in east London with an uncapped ten year ground rent doubling provision. Apart from the fact that the property itself does not seem to be a suitable comparable to the subject properties under discussion, the Tribunal notes that the valuation date in St Martins Avenue was December 2014. The cap rate formed only a minor part of the numerous issues in that case and there is no guidance in the decision itself as to how the Tribunal reached its decision on the 6% figure. On the plus side, the chosen rate is close to the rate proposed by the Respondents in the present case. Farringdon Court is similarly concerned with a single property but with a valuation date of October 2018 and in contrast with St Martins Avenue , Farringdon Court was a two bedroomed flat in a modern development in Reading. Property type and location are therefore comparable. The cap rate was the main issue in the case. Mr Kaye had acted for the Applicant in that case and his evidence comprised substantially the same comparables as he has used in this case. The lease in question started with 5 year rent reviews reverting to 25 year intervals after 25 years. Mr Evans for the Respondent in that case had chosen only auction sales as his comparables and the Tribunal took an average of his properties' cap rates (7.7%) as their starting point with Mr Kaye's 9.5% as the upper limit. On the evidence before them the Tribunal in that case concluded that the cap rate applicable to the single unit with which they were concerned fell between the two above mentioned figures and was set at 8.5%. Although the Tribunal was grateful to the Respondents for bringing this very recent decision to their attention they distinguish it from the present case because it dealt only with a single unit and it considers that the evidence from the block sales of Verona Apartments and Ferrymead Gardens is more relevant to the present circumstances than the various single transaction auction results reviewed in Farringdon Court.

25 Both valuers presented their evidence as experts. For the Respondents Mr McKeown's statement contained an expert's declaration in proper form whereas Mr Kaye's did not and despite being asked by the Tribunal to do so he only produced a signed declaration on the final day of the hearing after having been reminded by the Respondents' counsel to do so. Mr McKeown was criticised by the Applicants for his connections with the Respondents. The Tribunal accepts Mr McKeown's evidence that while he had previously been employed by the Respondents and still continued to do a substantial amount of work for them he was now totally independent of them and respectful of his overriding duty to the Tribunal. The Tribunal found his evidence to be measured and credible and acknowledged his experience in dealing with the type of property under scrutiny in this case. In turn, Mr Kaye's partiality was questioned by the Respondents largely because his website invites leaseholders

to instruct him if they 'have been trapped by a 10-year doubling ground rent' and states that 'the true cost to remove the ground rent is a fraction of these quotes [from your freeholder]'. While the Tribunal does not agree with the Respondents' assertion that these statements represent a direct conflict of interest between Mr Kaye's duty to his clients and his duty to the court it does consider that they may influence Mr Kaye's perspective because his own future success will inevitably be reflected by the outcome of the cases in which he advises. It was clear that Mr Kaye lacked experience both in dealing with property of the type under consideration here and of preparing and giving evidence as an expert which he had only done twice before. His attitude towards the valuation reflected his prior experience as an investment valuer and he appeared to have selected his comparables to suit his own client's purpose rather than objectively applying the specific criteria of the 1993 Act. None of his chosen comparables were considered by the Tribunal to be appropriate and he had only included Verona Apartments in his report because he had been made aware of it by the Respondents' valuer.

26 For the above reasons the Tribunal prefers the evidence of the Respondents' valuer to that of the Applicants and, having themselves re-considered all the comparables as part of their deliberations concludes that the only reliable comparables appear to be Verona Apartments and Ferrymead Gardens with cap rates of 6.3% and 5.9% respectively.

27 That being so it considers that the cap rate put forward by the Respondents' valuer of 6.15%, which lies between the rates of the two preferred comparables, is the appropriate cap rate to be applied to all the subject properties in this case. It should be stressed that this decision has been reached based on the particular facts of and evidence produced in this case. Other situations and different valuation dates may produce different results.

28 **The Law**

> Schedule 13 to the Leasehold Reform, Housing and Urban Development Act 1993 (The Act) provides that the premium to be paid by the tenant for the grant of a new lease shall be the aggregate of the diminution in the value of the landlord's interest in the tenant's flat, the landlord's share of the marriage value, and the amount of any compensation payable for other loss.

The value of the landlord's interests before and after the grant of the new lease is the amount which at the valuation date that interest might be expected to realise if sold on the open market by a willing seller (with neither the tenant nor any owner of an intermediate leasehold interest buying or seeking to buy) on the assumption that the tenant has no rights under the Act to acquire any interest in any premises containing the tenant's flat or to acquire any new lease.

Para 4 of the Schedule, as amended, provides that the landlord's share of the marriage value is to be 50%, and that where the unexpired term of the lease exceeds eighty years at the valuation date the marriage shall be taken to be nil.

Para 5 provides for the payment of compensation for loss arising out of the grant of a new lease.

Schedule 13 also provides for the valuation of any intermediate leasehold interests, and for the apportionment of the marriage value.

Name: Judge F J Silverman
sitting as Chairman

Date: 25 June 2019