

IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2018] UKUT 64 (LC)

Case No's: LRA/168/2016

LRA/170/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – flat – premium – market evidence preferred in valuation of current leases – adjustment for “Act rights” – adjustment for notional freehold value – capitalisation rate – appeals allowed

**IN THE MATTER OF APPEALS AGAINST TWO DECISIONS OF
THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)**

BETWEEN:

**JONATHAN HOWARD ROBERTS
JANET ANN THAIN**

Appellants

and

**(1) DAVID EDWARD GARDNER
(2) MARIA CHRISTINA O'HALLORAN**

Respondents

**Re: 5 & 13 Andace Park Gardens
Widmore Road
Bromley
BR1 3DH**

Deputy Chamber President, Martin Rodger QC, and Mr P D McCrea FRICS

Royal Courts of Justice, Strand, London WC2A 2LL

11 January 2018

Jonathan Roberts in person for the appellants
Peter L W Morgan FRICS for the respondents

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The following cases are referred to in this decision:

Contactreal Ltd v Smith [2017] UKUT 178 (LC)

Earl Cadogan v Erkman [2011] UKUT 90 (LC)

Elmbirch Properties Plc, Re 51 and 85 Humphrey Middlemore Drive [2017] UKUT 314 (LC)

Roberts and Thain v Fernandez [2015] UKUT 106 (LC)

Sinclair Garden Investments (Kensington) Ltd, Re George Court [2017] UKUT 494 (LC)

Introduction

1. Andace Park Gardens is a residential development of 88 flats in two blocks at Widmore Road in Bromley. The freehold is owned by the appellants, Mr Jonathan Roberts and his wife, Ms Janet Thain.
2. Ms Maria O'Halloran owns the long lease of flat 13, which has a term of 99 years from 25 March 1986. On 26 September 2013, when her lease had 71.87 years unexpired, Ms O'Halloran served a notice under section 42 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the Act") claiming a new extended lease.
3. Mr David Gardner is the long leaseholder of flat 5, held on similar terms to flat 13. He exercised his right to claim a new lease under the Act on 25 November 2015, when his lease had 69.33 years unexpired.
4. Since the premiums to be paid for the new leases could not be agreed, they were determined by the First-tier Tribunal (Property Chamber) ("the FTT") on 29 September 2016 at £16,100 (flat 13) and £22,300 (flat 5). Permission to appeal its decisions was refused by the FTT, but granted by this Tribunal which directed that the appeal would be conducted as a review of the FTT's decision with a view to a rehearing.
5. As he did before the FTT, Mr Roberts represented himself and Ms Thain at the hearing of the appeal, whilst Mr Peter Morgan FRICS acted as advocate and gave expert evidence for the respondents.

The relevant statutory provisions

6. Chapter II of the Act confers on the tenant of a flat the right to acquire a new lease of the flat on the payment of a premium calculated in accordance with the provisions of Schedule 13 to the Act. The new lease, under which no rent is payable, is for a term equal to the unexpired term of the original lease plus an additional 90 years.
7. The premium payable for each of the new leases in this appeal is agreed to be the aggregate of the two sums specified in paragraph 2(a) and (b) of Schedule 13.
8. The first of these is the amount by which the value of the landlord's interest in the tenant's flat is diminished by the grant of the new lease. That is the difference between the value of the landlord's interest in the flat prior to the grant of the new lease and the value of its interest once the new lease is granted, in each case assuming a notional sale on the open market subject to the relevant lease (Schedule 13, paragraph 3). For the purpose of the notional sale the tenant is taken not to be a potential buyer and the Act is taken to confer no right to acquire any interest in any premises containing the tenant's flat or to acquire a new lease of that flat.

9. The second component of the premium is the landlord's share of the marriage value created by the grant of the new lease, where the unexpired term of the current lease is more than 80 years. By paragraph 4 of Schedule 13 the marriage value is the difference between the aggregate of the value of the tenant's interest under the existing lease and the landlord's interest in the flat prior to the new lease being granted on the one hand, and the aggregate of the value of those interests after the grant of the new lease on the other. The landlord's share of the marriage value is 50% of this sum.

10. The determination of the premium therefore requires separate valuations of the existing lease and the new lease, and of the landlord's interest in the flat before and after the grant of the new lease.

The facts

11. Andace Park Gardens comprises two four-storey blocks built in the mid-1980's and set in landscaped grounds. Situated between the blocks is an outdoor heated swimming pool and a pavilion changing room including a gym, which are screened by a brick wall from a petrol filling station fronting Widmore Road. The development also includes garage blocks and car parking.

12. Flat 13 is on the first floor of the western block, facing the grounds. Its lease includes a separate garage.

13. Flat 5 is on the ground floor of the same block, and has direct access to the grounds and swimming pool. The lease of flat 5 includes a car parking space.

14. Each flat has two bedrooms, gas fired central heating and double glazing, and it is agreed that there are no improvements which require to be disregarded.

15. The leases of flats 13 and 5 are identical in all material respects. Each is for a term of 99 years from 25 March 1986, at an initial rental of £200 per annum, with rent reviews every 25 years, linked to RPI. The rents were increased to £478.24 per annum with effect from 25 March 2011, and are due to be reviewed again in 2036 and 2061. The leases also include an unusual provision that on any assignment the freeholder is to receive 1% of the premium payable for the leasehold interest.

16. The leaseholders of Andace Park Gardens have access to the swimming pool and leisure facilities under the provisions of separate leases, for which an additional rent and service charge are payable.

17. The agreed valuation dates for the purposes of determining the premiums are 26 September 2013 for flat 13 and 25 November 2015 for flat 5.

The FTT's decision

18. In determining the premiums of £16,100 for flat 13, and £22,300 for flat 5, the FTT's starting point was a finding that the value of the extended leases would be £255,000 and £330,000 respectively, based on the sales of other flats within Andace Park Gardens. It made no adjustment to the prices paid on those real world sales to reflect the fact that, while they were of leases under which the leaseholder enjoyed "Act rights", the notional sales of flats 5 and 13 were required to be on the assumption that the Act conferred no right to acquire a new lease of those flats.

19. The FTT next ascertained the values of the existing leases by applying a relativity percentage to its extended lease values (but making no adjustment to calculate notional freehold values) as this Tribunal had done when determining the price of another flat at Andace Park Gardens in *Roberts and Thain v Fernandez* [2015] UKUT 0106 (LC). We will refer to that decision as *Fernandez*.

20. In *Fernandez* the Tribunal (His Hon Judge Behrens and Mr N J Rose FRICS) considered that the evidence yielded by open market transactions was insufficiently detailed to provide a basis for reliable conclusions on the value of the existing unextended lease of No. 70 Andace Park Gardens. It therefore ruled that, on the evidence available to it, the FTT had been entitled to derive the value of the existing lease by adjusting the value of the extended lease by a relativity factor taken from relativity graphs. Those graphs suggested a relativity of 93.7% for an unexpired term of 71.964 years and the Tribunal endorsed the FTT's use of that figure.

21. Using the same tools, the FTT accepted Mr Morgan's small adjustment in the case of flat 13 (with a term of 71.49 years), and applied his relativity factor of 93.45% to its own extended lease value to arrive at a value for the existing unextended leasehold interest of £238,298.

22. In the case of flat 5, with an unexpired term of 69.33 years, the FTT adopted a relativity of 92.2% "having looked at such graphs as are before it". This produced an existing lease value of £304,260.

23. The FTT capitalised the freeholders' rental income at a yield of 6%, making no adjustment to reflect the periodic RPI-linked rent reviews in the existing leases, and used a deferment rate of 5%.

Issues

24. Permission to appeal was granted by this Tribunal on the following four issues:

1. Whether the FTT had been wrong to arrive at its existing lease values by adjusting the extended lease values by reference to graphs of relativity, rather than by using evidence of relativity derived from transactions within Andace Park Gardens.

2. Whether the FTT had been wrong not to make an adjustment to evidence derived from transactions in the “Act world” to reflect the fact that the notional sale was one in which the leaseholder enjoyed no rights under the Act.
3. Whether the FTT had failed to have regard to the evidence presented to it when it adopted a capitalisation rate of 6%.
4. Whether the FTT had been wrong not to take account of the provisions in the existing leases for RPI-linked rent reviews when compensating the freeholders for their loss of future rent.

25. We indicated to the parties at the start of the appeal our provisional view that the FTT’s approach to issues 1, 2 and 4 was wrong in principle and that the better course would be for us to re-hear their evidence. As they each wished to rely on new material we were willing to consider evidence on all aspects of the statutory valuation.

26. Over the course of the hearing the differences between the parties on valuation principles narrowed, but they grew no closer on quantum. They agreed that an extended lease has a slightly lower value than a notional freehold. Mr Morgan agreed that the increases in rent generated by the RPI-linked rent reviews should be reflected separately in the valuation, and should not simply be subsumed in the capitalisation of the passing rent. He also agreed that an adjustment to the comparable transactions should be made to reflect the real-world enjoyment of “Act rights” which must be assumed not to be available to the notional purchaser.

27. Accordingly, the issues on which the argument focussed were:

1. The extended leasehold and notional freehold values, including the freehold differential and whether the lease terms are onerous.
2. The unextended leasehold values, including whether there should be an allowance for the notional absence of “Act rights”, and relativity.
3. How the freeholders should be compensated for the loss of RPI rent increases.
4. The capitalisation rate to be adopted in the statutory calculation.

Issue 1 – Extended leasehold and notional freehold values

The extended lease values

28. Neither Mr Roberts nor Mr Morgan disagreed with the FTT’s determination of the extended leasehold value of flat 13 at £255,000, but as we explain below they drew different conclusions as to what this figure represented. That consensus was reached in the knowledge that in the same month, September 2013, flat 53, also a first floor flat, sold for £245,000.

29. Mr Roberts valued the extended leasehold interest in flat 5 at £343,000. Mr Morgan's valuation was £326,700.

30. Mr Roberts' sole comparable for flat 5 was the sale of the 159-year lease of flat 69 at £350,000 in April 2016. He reflected the change in average values over the five month period from the valuation date using the Land Registry index for flats and apartments in Bromley¹, to arrive at an equivalent value of £343,000.

31. At the FTT, Mr Morgan had valued the extended leasehold interest in flat 5 at £322,700 (before making a deduction for improvements) by reference to five comparable sales within the development. These comprised the sales of two extended leasehold properties (flats 28 and 68), and three held on unextended leases (flats 60, 64 and 72), which he adjusted to long-leasehold equivalent figures by adopting the relativity used in *Fernandez*.

32. The FTT did not consider this evidence to be of assistance, because the long leasehold sales were more than year earlier than the valuation date, and because flats 60 and 68 only had one bathroom. It considered the sale of flat 28, at £295,000 in August 2014, to be the best comparable (despite this also being more than a year earlier than the valuation date).

33. It noted that none of the comparable properties has the advantage enjoyed by flat 5 of being able to walk from their patio straight into the gardens and swimming pool complex, and it determined the value of flat 5 at £330,000. Before us, Mr Morgan said that he was content to adopt the FTT's figure, but as we discuss below he assumed that this represented the value of the freehold interest, and he adjusted this by 1% to give an extended lease value of £326,700.

34. Mr Morgan relied on additional evidence of long leasehold sales within the development in support of his opinion of relativity, which we deal with below, but they are also of assistance in assessing the extended leasehold value of flat 5.

35. Mr Roberts and Mr Morgan both used the Land Registry Index for flats and apartments in Bromley, but there appeared to us to be discrepancies between the figures used, as well as some mathematical errors. In particular Mr Morgan's report included an adjustment of the sale prices of various one and two-bedroomed flats by reference to a common valuation date of June 2016. He said that he picked this date since it was the date of the last transaction he had, and that there would be no difference to the adjusted figures if the valuation date of flat 5 – November 2015 – had been used.

36. On closer analysis, Mr Morgan's assumption that the chosen index date should have no effect on the adjusted figure is only true if both dates (i.e. the arbitrary index date chosen, and the actual valuation date) are before (or are both after) the date of the comparable transaction which is being adjusted. The problem comes when the arbitrary index date – in this case Mr

¹ Mr Roberts' figures: 106.99 in November 2015, and 109.10 in April 2016

Morgan's June 2016 – is after the date of the comparable transaction, but the actual valuation date – November 2015 for flat 5 – is before it. By way of illustration, take the sale of flat 69 at £350,000 in April 2016. The relevant indices from the Land Registry are as follows:

(Valuation date of flat 5) November 2015:	107.7
(Date of comparable (flat 69) to be adjusted) April 2016:	112.61
(Mr Morgan's adjustment date) June 2016:	116.1

37. Mr Morgan's adjusted figure for the sale of flat 69 was £359,570. He has not provided his index figures, but, on the above figures, what we think Mr Morgan did was multiply £350,000 by (something close to) 116.1/112.61 to arrive at, on our figures, £360,847. In fact, since the date of valuation was earlier than the date of the comparable transaction, with a lower index figure, the value of flat 69 should be adjusted by multiplying the April 2016 sale price of £350,000 by 107.7/112.61 viz. £334,739.

38. In view of these discrepancies, we are not prepared to rely on the indexed values provided by Mr Morgan. Instead, we have looked afresh at the House Price Index for flats and maisonettes in Bromley over the relevant period², applying it to the five comparable transactions which Mr Roberts and Mr Morgan produced by reference to the valuation date for flat 5 – November 2015.

Flat	Sale Price	Date of Sale	Index figure	Adjusted price	Unexpired term	Rent	Position
25	£237,000	June 2013	79.19	£322,324	161	£0	Third
53	£245,000	Sep 2013	81.34	£324,397	161	£0	First
68	£265,000	June 2014	93.45	£305,409	125	£478.24	Second
28	£295,000	Aug 2014	96.84	£328,082	160	£0	Third
5		Nov 2015	107.7		159	£0	Ground
69	£350,000	April 2016	112.61	£334,739	159	£0	Third

39. It can immediately be seen that our analysis of the indexed sale price of flat 69 differs from that of Mr Roberts' only comparable transaction – reducing it from £343,000 to £334,739.

40. In our judgment, the sale of flat 68 provides no assistance, since the lease extension was by negotiation (presumably with the appellants), and on terms significantly different from those required to be assumed, in that the ground rent remained payable at the same unchanged rate

² <http://landregistry.data.gov.uk/app/ukhpi/browse?from=2013-01-01&location=http%3A%2F%2Flandregistry.data.gov.uk%2Fid%2Fregion%2Fbromley&to=2016-12-01>

but subject to 5 yearly rent reviews, rather than being reduced to nil. Whilst Mr Morgan's evidence was that the level of rent plays no part in sale prices, a brief glance at the adjusted sale prices suggests a different story.

41. Ignoring flat 68, therefore, an average November 2015 sale price of £327,386 can be derived from the evidence of sales of long leases in the development.

42. We add at this point that, whilst the comparable evidence was drawn from different parts of the development, neither party sought to apply any adjustment for quality, position within the blocks, outlook, or floor level, despite the criticism levelled at that approach by the Tribunal in *Fernandez*. Mr Roberts and Mr Morgan agreed that the two-bedroomed flats were all of similar size, and there was a limit to how they could be adapted in any way that would have an effect on value. Whether a flat had a garage or parking space also appeared to have negligible effect on value. On the basis of that evidence (which was not provided to the Tribunal in *Fernandez*) we accept that, in general, further differentiation is unnecessary. We nevertheless agree with the FTT that there are advantages, which would be reflected in value, in being on the ground floor with easy access to the leisure facilities.

43. We are also conscious that whilst indices are regularly used to adjust for time in such cases, the reliability of the evidence must decrease the further from the valuation date the transaction occurred. The Tribunal has recently commented in *Elmbirch Properties Plc, Re: 51 and 85 Humphrey Middlemore Drive* [2017] UKUT 0314 (LC) (at [82]) that transactions which require adjustment using indices covering a three-year period must carry a health warning. We repeat that warning.

44. We therefore consider that more weight should be placed on the adjusted price of flat 69, only five months after the valuation date, than on the earlier transactions, the most recent of which was over 12 months earlier.

45. Doing the best we can from the available evidence, we consider that the extended lease value of flat 5 is £340,000.

Freehold differential

46. One component of the value of a landlord's interest in a leasehold flat is the current value of the freehold reversion (i.e. the right to possession of the flat when the lease expires). In order to ascertain this value it is necessary to establish the current freehold value of the flat, as if notionally it was not subject to the lease, and then to defer that value for the remainder of the term.

47. In the Tribunal's recent decision in *Contactreal Ltd v Smith* [2017] UKUT 0178 (LC) the existence of a difference in value between a long lease and an unencumbered freehold of the same property was taken to be an established matter of valuation principle which ought not to

be departed from except where there was evidence to justify doing so. At paragraph [70] the Tribunal (Mr A.J. Trott FRICS) said that “the relativity of even the longest lease may approach 100% but will not reach it.” Reference was made to *Earl Cadogan v Erkman* [2011] UKUT 90 (LC) in which the Tribunal suggested how that difference may be quantified at different long lease lengths: “Leases with unexpired terms of 100 to 114 years - 98%; 115 to 129 years - 98.5% and above 130 years - 99%.”

48. The FTT made no such allowance when determining the value of the freehold interests in this case. It is now agreed that the notional freehold value of the flats would be higher than the value of the long leasehold interests and that an adjustment is required to take this into account. Mr Morgan accepts that an upward adjustment of 1% is required (which is consistent with the Tribunal’s view in the recent cases we have referred to). There nevertheless remain two issues. The principal issue is the amount of the adjustment to be applied, in light of Mr Roberts’ case that more than 1% is required; the second issue concerns the appropriate adjustment to the FTT’s extended leasehold value for flat 13, which is not challenged, to arrive at a notional freehold value.

49. Mr Roberts’ approach was to add a fixed sum of £7,000 to the extended lease value of both flats. In part this addition was to reflect the depressing effect on the value of the extended leases in the development of what Mr Roberts considered to be the onerous terms of the existing lease. Mr Roberts suggested that the value of the extended leases would have been greater had they not been burdened by the onerous lease terms and that a greater adjustment was required to arrive at an unencumbered freehold value as a result.

50. The onerous terms in question were the leaseholder’s liability to pay 1% of the sale price plus VAT to the freeholder on each assignment of the lease; the obligation to make a contribution approaching £500.00 pa towards the cost of the leisure facilities; the reservation of a high ground rent, increased by RPI every 25 years; and the requirement to obtain a licence from the landlord before any assignment or underletting. Without those onerous terms Mr Roberts believed the prices at which the flats would be sold would be higher. This approach had been accepted by a leasehold valuation tribunal in 2008 in a decision concerning flats in another block in the area held on the same terms where £6,500 had been added to the extended leasehold value of one bedroom flats and £7,000 to two bedroom flats to arrive at a notional freehold value.

51. In the case of flat 5, Mr Roberts’ £7,000 addition represented 2% of his freehold valuation figure of £350,000; he considered that the usual differential between the value of the freehold and of a long lease would be only 1%, and that the additional 1% reflected the depressing effect of the onerous lease terms. Despite this rationalisation Mr Roberts used the same £7,000 uplift in the case of flat 13, where it equated to a total increase in the order of 2.67%.

52. Mr Morgan did not consider the lease terms to be onerous, relying on what the Tribunal had said in *Fernandez* at [29-30]:

“29. Mr Roberts’s arguments rested on the proposition that the element of the ground rent which exceeded 1% of the freehold value, together with certain other lease features, would be considered onerous in the market. The only support for that proposition, before the F-tT and on re-hearing before us, consisted of certain LVT decisions and the assertions of an advocate with a financial interest in the outcome of the case. Moreover, insofar as those decisions suggested the ground rent was onerous, they were inconsistent with the RICS research paper.

30. It is clear from *Arrowdell* that LVT decisions do not constitute useful evidence in subsequent proceedings. The RICS research paper, on the other hand, is valid evidence of the opinion held by the experienced practitioners who compiled the document. There was thus no evidence before the F-tT, or before this Tribunal on re-hearing, to support either of the adjustments put forward by Mr Roberts, which we reject.”

53. We are equally unpersuaded that the lease terms are onerous to the extent that they justify an additional uplift to represent the difference in value between the extended lease and the notional freehold.

54. The obligation of the leaseholder to pay 1% of the purchase price to the landlord within 21 days of every assignment would add £2,450 to the transaction costs on the sale of the extended lease of flat 13 and £3,400 on the sale of flat 5. No evidence, beyond his own assertion, was produced by Mr Roberts in support of the argument that the obligation to make a payment of this magnitude has had a measurable impact on the price at which flats in the development have been sold. The obligation to make the payment was not mentioned in the sales particulars we were shown and there was no evidence of any prospective purchaser reducing the price they were prepared to offer on becoming aware of the additional cost. While we agree that, in principle, the imposition of an additional cost of sufficient magnitude might be expected to depress the value of a property, we are not satisfied that a case has been made out that a payment of this amount would have any such effect.

55. The gym and swimming pool are attractive features of the development which are emphasised in all of the sales particulars we were shown, and we consider they are likely to enhance rather than reduce the value of the flats. The leaseholder’s obligation to pay towards the cost of providing those leisure facilities is in return for the right to use them. We were provided with no evidence of the cost of using an alternative gym or swimming pool in the locality and we are not persuaded that a charge currently of about £500 per annum for the use of such facilities in very close proximity to one’s home is onerous.

56. Nor do we accept that an obligation to pay a ground rent of £478 a year, fixed for the greater part of 21 years, would have a depressing effect on the value of a long lease. In any event, the extended lease value is derived from sales of comparable flats in the development where the lease has already been extended under the Act and the requirement to pay a ground rent has been eliminated.

57. The requirement to obtain the landlord's licence for any assignment or underletting is fully qualified, and consent may not be unreasonably withheld. No evidence was given that this had a detrimental effect on value. Nor was there any evidence of consent ever having been refused, so as to give rise to concern amongst prospective purchasers that they may have difficulty in selling or underletting their flat. In the absence of evidence we do not accept that such a covenant is onerous; indeed, it might be regarded by some leaseholders as beneficial that the landlord could reasonably refuse to allow other flats in the block to be acquired by some undesirable purchaser.

58. As the Tribunal has done in the recent cases of *Elmbirch*, *Contactreal* and *Earl Cadogan v Erkman* we have adopted a 1% differential – and have taken the extended leasehold interest to represent 99% of the value of a notional freehold. In the case of flat 5, that produces a freehold figure of say £343,500, based on our long leasehold value of £340,000.

59. In the case of flat 13, the FTT made no such allowance, and adopted £255,000 as the value of both the extended leasehold and freehold interests. Mr Roberts was correct to add on an element to reflect the additional value of the freehold interest – although we do not agree his additions of 2-2.67%. Mr Morgan took the FTT's £255,000 and made a deduction from it – assuming that the figure of £255,000 was the FTT's freehold value. That has a double-counting effect in our view. The FTT's figure was the extended leasehold value, to which it made no addition to arrive at a freehold value. We consider that it should have added 1% and have therefore adopted a notional freehold value of say £257,500.

Issue 2 – The existing leasehold values

60. The value of the existing leasehold interests in both flats was in issue, and it is convenient to deal with them together.

61. For the 69.33 year unexpired lease of flat 5, Mr Roberts' valuation was £309,000; Mr Morgan's was £304,260. It is surprising that they were unable to reach an accommodation over the 2% difference. The range of opinion over the value of the 71.5 years remaining on the lease of flat 13 was not much wider – Mr Roberts' £229,500 playing Mr Morgan's £237,915.

62. Mr Roberts considered that there was abundant evidence from sales in the block to support a relativity of "at least" 90% of the freehold values, (by which he meant 90% or less), but said that he would be content with 90%. He suggested that his view was reinforced by two decisions of the FTT. For 21 Andace Park a relativity of 90% was determined where the lease had 74.389 years unexpired, on the strength of which around 30 leaseholders (represented by Mr Morgan) had settled their claims for lease extensions. More recently, the FTT dealt with 75 Andace Park, in which it determined an existing lease value (with 68 years unexpired) of £221,122 and a notional freehold value of £256,520, showing a relativity of 86.2%.

63. In his witness statement to the FTT regarding flat 5, Mr Roberts relied on the sale of flat 64 in August 2015 at a price of £305,000, only three months before the valuation date. The

lease had not been extended and had 69 years unexpired. Mr Roberts considered this provided ample evidence to support a conservative value for flat 5 of £300,000. To reflect the fact that flat 64 was sold with “Act rights”, he had invited the FTT to make a deduction of 3%, or £9,000, from his valuation of £300,000 to arrive at £291,000 as the assumed value of flat 5 without “Act rights”. This 3% was derived from the Savills June 2016 Report “Spotlight: Leasehold Enfranchisement”.

64. In Mr Roberts’ evidence before us his valuation of flat 5 had increased to £309,000, although he made a deduction for “Act rights” of £10,000 in his subsequent marriage value calculation. That seemed to us, on the face of it, to be a mathematical error, but in answer to questions Mr Roberts said that the 3% *addition* (£9,000 on £300,000) was probably due to indexation, although he didn’t seem terribly sure.

65. Mr Roberts’ witness statement to the FTT on flat 13 referred to the sale of flat 72 in January 2014 at £250,000 (although he considered that negotiations must have started by October 2013 at the latest). He also relied on the sale of flat 60 in April 2014, also at £250,000. He considered that this evidence supported a valuation of the existing leasehold interest in flat 13 in September 2013 at £250,000, but he deducted £6,500 for the absence of “Act rights” to arrive at a value of £243,500. Before us, Mr Roberts’ views had changed and he suggested the same evidence supported figures of £237,915, or £229,500 without “Act rights”, based on a notional freehold value of £262,000 and a relativity of 87.5% (or, as he calculated it, 90% of the extended leasehold value of £255,000).

66. Mr Morgan agreed with Mr Roberts that there was now sufficient evidence of the sales of unextended leases within the development to make it unnecessary to rely on graphs of relativity, although he thought the transactional evidence was consistent with the graphs. He produced an analysis which he said pointed to a relativity range from 96.8% for 70.3 years unexpired, to 95.3% for 69.3 years unexpired. He considered this range showed that the FTT had not been too generous when it adopted 92.2% for flat 5 and 93.3% for flat 13. In *Fernandez* the Tribunal had adopted 93.7% for a lease having 72 years unexpired, based on graphs.

67. Mr Morgan applied the same 92.2% as the FTT to his own freehold value of £330,000 to arrive at a value for the current lease of flat 5 of £304,260. For flat 13 he used the FTT’s 93.3% and his own freehold value of £255,000 to arrive at £252,546 for the value of the existing lease.

68. If an adjustment for “Act rights” was appropriate, Mr Morgan said he could “live with” 3.5%, which would reduce the relativity range so that it lay between 93.3 and 91.8%.

69. A range of transactional evidence was produced as an alternative route to the ascertainment of the unextended leasehold values. Three sales of two bedroomed flats (with flats 5 and 13 included for reference) could be adjusted to the two valuation dates of September 2013 and November 2015 as follows:

Flat	Sale Price	Date of Sale	Index figure	Adjusted to Sep 13	Adjusted to Nov 15	Unexpired term	Position
13		Sep 2013	81.34	-	-	71.87	First
72	£250,000	Jan 2014	84.84	£239,686	£317,362	69	Third
60	£250,000	April 2014	88.03	£231,000	£305,861	69	First
64	£305,000	Aug 2015	103.83	£238,935	£316,368	69	Second
5		Nov 2015	107.7		-	69.33	Ground

70. The sale price of flat 60 seems on the face of it to be slightly low, four months after the sale of flat 72 in a rising market, but as we indicate above there is insufficient detail of the particular characteristics of each flat to investigate further. Whilst it is tempting to ignore the sale of flat 60 because the other two sales, when adjusted for time, are extremely close, we do not consider we can simply disregard it. Including flat 60, the average sale price of leases with 69 years unexpired was £236,541 at the valuation date for flat 13, or £313,197 at that of flat 5.

71. The FTT's relativities were taken from the Tribunal's decision in *Fernandez*, where the Tribunal decided that the FTT in that case had been entitled to base its decision on the six relativity graphs in the RICS Research Report, as it had not been provided with sufficient market evidence. At [20] the Tribunal said this:

"We would add that the FTT's task would no doubt have been simpler if it had been provided with reliable market evidence. Mr Morgan did produce various sale prices achieved for long and short leases, but the supporting information was limited to the property's address, sale date, price paid and lease length. No information was given to indicate, for example, the condition of the flat, the extent of any tenant's improvements, on which floor in the building it was located or whether there was a lift. Without such information it is not possible to draw any meaningful conclusions from the sale prices. What is certain, however, is that a long lease is more valuable than a short lease in an otherwise identical property, contrary to the reverse position suggested by the sales in *The Oasis*, *The Laurels* and *Kingsway Court*, referred to by Mr Morgan."

72. The Tribunal has consistently indicated a preference for market evidence where it is available, and has warned that graphs should only be considered if the market evidence is inconclusive. It seems clear that had market evidence been available to the Tribunal in *Fernandez*, it would have preferred it to that of graphs. In view of the close alignment of the evidence when adjusted for time, and the parties' agreement that such details as location within the development or the floor a flat is on do not affect value, we are satisfied that we now have sufficiently reliable market evidence before us to obviate the need to rely on graphs.

73. We therefore propose to base our short leasehold valuation for flat 5 on the average sale price of the three short leasehold sales, adjusted to £313,197 as at November 2015.

74. At the valuation date for flat 13, September 2013, the comparable evidence suggests an average value of £236,541 which would equate to a relativity of 91.86%. But that has been derived from transactions in leases each of which had an unexpired term of 69 years. At the valuation date, the lease of flat 13 had 71.87 years unexpired. We propose to reflect this by adding 0.5% to the relativity percentage, applying 92.36% to the notional freehold value of £257,500 to arrive at £237,827.

75. The short leasehold values derived from the comparable transactions must then be adjusted for “Act rights.” The benefits of these rights were outlined in *Elmbirch* at [29]–[31] where a deduction of 3.5% was made for leases having unexpired terms of 68.62 and 68.67 years, following a similar deduction for a lease having 67.49 years unexpired in *Contactreal* .

76. More recently, in *Sinclair Garden Investments (Kensington) Ltd, re George Court* [2017] UKUT 0494 (LC) the Tribunal also deducted 3.5% for a lease having 66.81 years unexpired.

77. The unexpired terms in the subject properties are not so different from these examples to require a different adjustment. A deduction of 3.5% is therefore appropriate in the case of flats 13 and 5.

78. Accordingly we find that the existing leasehold values of the appeal flats, assuming no “Act rights”, were, with a small amount of rounding, £229,500 for flat 13, and £302,250 for flat 5. These figures represent a relativity factor of 89.13% to notional freehold value in the case of the 71.87 years unexpired lease of flat 13, and 87.99% for the 69.33 years unexpired lease of flat 5.

Issue 3 – Compensating the freeholders for the loss of future rent increases

79. We can deal with this issue fairly shortly. There is no issue of principle between the parties – only quantum is to be decided. Again, it is disappointing that the issue remains live, since barely £200 separates the parties. The disagreement arises from the presence in the leases of 25 year rent reviews in line with RPI, resulting in future rental levels which are not yet known. The original rents of £200 per property were reviewed, on this basis, to £478.24 per annum.

80. It is common in enfranchisement calculations for future rent increases to be reflected in a multi-stage “term and reversion” valuation. When the rent is to be increased to fixed amounts agreed at the start of the lease, the valuer can capitalise that rental income from its future effective date, taking into account the fact that that portion of income will not be not receivable until the review date by making a present value reduction. So, the principle of future rental increases being reflected is well established.

81. How should a future increase to an unknown level based on RPI be valued? Mr Roberts’ approach was relatively complicated, but in essence he applied the RPI increase which occurred

between the start of the lease and the valuation date to establish a notional rental level as if the rent had been capable of being reviewed at the valuation date. He then deducted the current rent from that figure, and then reduced the net figure at a discount rate of 2.5% for the period between the valuation date and the next rent review date. In the case of flat 5, this resulted in an additional notional annual rental income of £35.39, and in the case of flat 13, £24.44. He capitalised these figures for the 49-year period (between the next rent review date and the end of the lease) at 5%, to arrive at £642.99 in the case of flat 5, and £444.04 in the case of flat 13. When asked by the Tribunal why the notional increase in rental income was not already implicitly included in the capitalisation rate of 5%, he said that this approach should be displaced where better information is available, although he was content for the rental increase from the final rent review to be reflected in the 5% rate.

82. Mr Morgan did not dispute the principle of there being additional present value in the RPI increasing rent. He calculated increases in the freeholders' current interests of £186 in the case of flat 5, and £244.09 in the case of flat 13.

83. Whilst the amounts in issue are negligible, we outline below our preferred method for assistance in future cases.

84. Mathematically, Mr Roberts has arrived at the same amount for the extra rental income as he would have done had he carried out a conventional reversion valuation. He has deferred the notional rent using a present value formula, and then capitalised the period for which that reduced rental income is receivable. The more conventional approach (if a "core and topslice" method is used since the "core" rental income of £478.24 per annum has already been calculated for the whole term) would be to capitalise the expected rental income for the period of 49 years over which it will be receivable, and then defer that capital amount. If the valuation is set out in that way, the anomaly of Mr Roberts' method is more apparent.

85. In the case of flat 13, it would be something like this (which only differs from Mr Roberts' £444.04 owing to rounding):

Increase in rent from review at March 2036	£42.59 pa
x years purchase for 49 years (from the	
review date until the end of the term) @ 5%:	18.169
x PV £1 for 22.87 years @ 2.5%	<u>0.5685</u>
	£439.95

86. Whilst in other parts of his calculation Mr Roberts used a deferment rate of 5%, in his view a rate of 2.5%, matching the government's target rate for inflation, was more appropriate when dealing with a rent review linked to RPI. We think that is an inconsistent approach. The whole point of a deferment rate is to reflect the time value of money, and to offset the effect of inflation on the delay in receiving income. It is common in conventional term and reversion

valuations for future rental income, or indeed the freehold reversionary interest, to be deferred using a uniform rate throughout. We prefer to do so in this case, and since the reversionary deferment rate has been agreed between the parties at 5%, that is the rate we have adopted.

Issue 4 – Capitalisation rate

87. The final issue in this appeal concerns the capitalisation rate, where Mr Roberts is at 5%, whilst Mr Morgan is at 6%. The FTT used 6%, as it subsequently did in a decision in respect of 75 Andace Park which Mr Roberts commended to us as a model decision.

88. Mr Roberts considered that the capitalisation rate should reflect what happens in the market, and he relied on three valuation reports carried out for secured lending purposes by Allsops, in which a general commentary on low yields was provided. In the latest valuation report, which concerned an apartment block in Manchester, the ground rent investment was valued at an initial yield of 2.85%, rising to 5.71% after rent review (which Mr Roberts considered would equate to a net yield of around 5.3%).

89. Mr Morgan's evidence was that before the FTT, he had followed the capitalisation rate of 7% adopted by the Tribunal in *Fernandez*. He acted for many leaseholders and said that he "nearly always" agrees 7% with the freeholder's valuer. He produced a schedule showing 24 settlements in various locations, all of which save two (which were at 8%) were based on capitalisation rates of 7%, although he accepted in cross-examination that in none of those cases had the rents involved been as high as £478.24. Despite this experience Mr Morgan was prepared to reduce his capitalisation rate to the 6% adopted by the FTT.

90. As far as sales of blocks of flats in the market were concerned, Mr Morgan's opinion was that these were meaningless as evidence of an appropriate capitalisation rate for a ground rent which was to be valued in isolation. The yields paid in the market reflected the expectation the purchaser of a leasehold reversion would have that profit could be made from insurance commissions and the organisation of repairs, as well as windfalls from lease extensions. Mr Morgan accepted that he had no experience of buying and selling ground rent investments.

91. The settlements negotiated between Mr Roberts and Mr Morgan after the Tribunal's decision in *21 Andace Park* were at 6%. Mr Morgan said that he hadn't included those in his schedule of evidence because they were some time ago, and he wouldn't agree that rate now.

92. We have some sympathy with Mr Roberts' view, and accept that there are grounds to suggest that yields should be below those traditionally used in this block and others. Nevertheless, we also find force in Mr Morgan's point that the yields paid by freehold investors for substantial blocks of property, with a variety of tenants from whom premiums might be obtained for a range of reasons, is not representative of the yield which could be achieved on a sale of the reversion to an individual flat. In agreement with the FTT we therefore consider that 6% is the appropriate capitalisation rate in this case.

Conclusions and determinations

93. We attach the Tribunal's valuations as an appendix, based on the following elements:

Flat	13	5
Notional freehold value	£257,500	£343,500
Extended lease value	£255,000	£340,000
Existing lease value	£229,500	£302,250
Unexpired term	71.87 years	69.33 years
Relativity	89.13%	87.99%
Marriage Value	£9,801.76	£18,151.34
Current freehold interest	£15,793.93	£19,743.15
Premium payable	£20,694.81	£28,818.82

94. The appeals therefore succeed. The premium payable by Ms O'Halloran for a new lease of flat 13 is £20,694.81. The premium payable by Mr Gardner for a new lease of flat 5 is £28,818.82

Martin Rodger QC
Deputy Chamber President

Peter D McCrea FRICS

2 March 2018

Appendix - Tribunal's Valuations

Flat 13 Andace Park Gardens, BR1 3DH							
<i>Current interests</i>							
Freeholder:							
	Present rent			£478.24			
	yp	71.87 yrs @	6%		16.4137		
							£7,849.67
	Increase of			£42.59			
	yp	49 yrs @	6%		15.7076		
	x pv £1	22.87 yrs @	5%		0.32764		
						5.146474165	
							£219.19
	Reversion to:			£257,500			
	x pv £1	71.87 yrs @	5%		0.03		
							£7,725.07
							£15,793.93
Leaseholder:							
							£229,500
Combined Current Interests:							
							£245,294
<i>Proposed Interests</i>							
Freeholder:							
	Reversion to:			£257,500			
	x pv £1	161.87 yrs @	0.05		0.00037		
							£95.69
Leaseholder:							
							£255,000
Combined proposed interests:							
							£255,095.69
				Marriage value:		£9,801.76	
				Premium payable @			
				Current Freehold interest			
				plus 50% of Marriage Value:			£20,694.81

Flat 5 Andace Park Gardens, BR1 3DH							
<i>Current interests</i>							
Freeholder:							
	Present rent				£478.24		
	yp	69.33 yrs @	6%		16.3733		
							£7,830.37
	Increase of				£42.59		
	yp	49 yrs @	6%		15.7076		
	x pv £1	20.33 yrs @	5%		0.37087		
						5.825465259	
							£248.11
	Reversion to:				£343,500		
	x pv £1	69.33 yrs @	5%		0.03396		
							£11,664.67
							£19,743.15
Leaseholder:							
							£302,250
Combined Current Interests:							
							£321,993
<i>Proposed Interests</i>							
Freeholder:							
	Reversion to:				£343,500		
	x pv £1	159.33 yrs @	0.05		0.00042		
							£144.49
Leaseholder:							
							£340,000
Combined proposed interests:							
							£340,144.49
					Marriage value:	£18,151.34	
					Premium payable @		
					Current Freehold interest		
					plus 50% of Marriage Value:		£28,818.82