

IN THE UPPER TRIBUNAL (LANDS CHAMBER)



Neutral Citation Number: [2016] UKUT 0468 (LC)
Case No: LRA/7/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – Premium – Leasehold Reform, Housing and Urban Development Act 1993 Schedule 13, Part II – unimproved freehold value – existing lease value – relativity – transactional evidence – relativity graphs – transactional evidence preferred – premium determined at £21,908

IN THE MATTER OF AN APPEAL FROM A DECISION OF
THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)

BETWEEN:

MR NICK MALLORY AND OTHERS

Appellants

- and -

ORCHIDBASE LIMITED

Respondent

Re: 7 Chenies Court, 10 Chenies Court
and 30 Datchet Close,
Woodhall Farm
Hemel Hempstead,
Hertfordshire
HP1 1SX

Before: His Honour Judge David Hodge QC and Peter D McCrea FRICS

Royal Courts of Justice, London WC2A 2LL
on
26 October 2016

Nick Mallory for himself and the other Appellants
Stan Gallagher for the Respondent

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The following cases are referred to in this Decision:

The Trustees of the Sloane Stanley Estate & Anor v Mundy & Ors [2016] UKUT 0223 (LC)
Re Coolrace and Ors [2012] UKUT 69 (LC), [2012] 2 EGLR 69

DECISION

Introduction

1. This is an appeal by the tenants of three long-leasehold flats at Woodhall Farm, Hemel Hempstead, HP1 1SX against a decision of the First-Tier Tribunal (Property Chamber) (“the Ft-T”) dated 4 December 2015, in which the Ft-T determined that the premium payable by the tenants to acquire an extended lease under section 56 of and schedule 13 to the Leasehold Reform, Housing and Urban Development Act 1993 (“the 1993 Act”) should in each case be £21,915. Permission to appeal was granted on 29 February 2016 by the Deputy President (Martin Rodger QC), who directed that the appeal should be dealt with as a re-hearing of the applications to determine the price payable for each of the new leases under this Tribunal’s standard procedure.

2. The appellant tenants (“the appellants”) are Mr Nicholas Mallory and Ms Donna Torrance, of 7 Chenies Court; Mr Graeme North and Ms Dominique North of 10 Chenies Court; and Ms Susan Tankard of 30 Datchet Close. We will refer to the three properties as “the appeal flats”. The appellants were represented by Mr Mallory.

3. The respondent freeholder, Orchidbase Ltd, was represented by Mr Stan Gallagher of counsel who called Mr Laurence Nesbitt BSc (Hons) FRICS MCI Arb to give expert valuation evidence.

4. The parties agreed that we would not be assisted by a view of the appeal flats, since it was agreed that the flats were all very similar, that access to the comparable properties could not be gained, and that in any event 10 Chenies Court had been refurbished since the valuation date.

Facts

5. From the evidence we find the following facts. Chenies Court and Datchet Close are adjacent blocks of flats within a residential cul-de-sac situated off Arkley Road forming part of the Woodhall Farm Estate, Hemel Hempstead. Woodhall Farm is an established residential estate comprising a mix of houses and flats, developed in the 1970s. It is situated to the north east of the town centre and benefits from easy access to the M1 motorway at junction eight.

6. Each of the appeal flats is situated in a three-storey purpose-built block. Access to the individual flats is via a communal entrance controlled by an entry-phone system with communal hallways and staircase access to the upper floors. Each block is surrounded by garden areas and has on-site parking. The approximate gross internal area of each flat is 51.03 m² (549 ft.²) and it comprises an entrance hall, living room, kitchen, two bedrooms and a bathroom.

7. Each of the appeal flats is held on a lease having a term of 99 years from 25 December 1973. In each case, the appellants’ notice under section 42 of the 1993 Act was dated 22 April 2015 which is therefore the valuation date, and at which point there were 57.68 years unexpired.

At the valuation date the rent passing was £50 per annum which was due to increase to £90 per annum with effect from 25 December 2039.

8. The freehold of each of the appeal flats is subject to an intermediate lease for a term of 99 years plus one day from 25 December 1973 at a peppercorn rent. It was common ground that the intermediate lease is controlled by the respondent freeholder and that for the purposes of our deliberations the intermediate lease can be disregarded.

Statutory provisions

9. Part II of Schedule 13 to the 1993 Act provides the framework under which the premium payable in respect of the grant of a new reversionary lease shall be calculated. In so far as relevant to this appeal, this is, in essence, that the premium payable by the appellants shall be the aggregate of—

- a) the diminution in value of the landlord's interest in the tenant's flat (being the difference between the value of the landlord's interest prior to the grant of the new lease and the value of its interest in the flat once the new lease is granted, in each case assuming a sale on the open market subject to the relevant lease, with neither the tenant nor any owner of an intermediate leasehold interest buying or seeking to buy); and
- b) 50% of the marriage value created by the new lease (being the difference between the aggregate of the value of the tenant's interest under the existing lease and the landlord's interest prior to the new lease being granted and the aggregate of those interests following the grant of the new lease).

Agreed Matters

10. It is common ground that the framework under schedule 13 to the 1993 Act forms the basis of calculating the premium to be paid, and that:

- a) at the valuation date of 22nd of April 2015 each lease had 57.68 years unexpired.
- b) in respect of the freeholder's current interest, the capitalisation of the income stream to the end of the lease had a value of £796.
- c) The deferment rate to be applied to the freehold reversionary interest should be 5%.

Matters for determination

11. The issues in dispute, which we deal with in turn, are:

- a) the unimproved freehold value of each flat.
- b) the relativity of the value of a lease with 57.68 years unexpired at the valuation date, compared with that of a virtual freehold.
- c) and therefore the premium to be paid for new 90-year reversionary leases, extending the term of each lease to 147.68 years.

The unimproved value of the appeal flats

12. In his report to the Ft-T, Mr Nesbitt arrived at an extended long lease value of each of the appeal flats of £145,000. In doing so he had regard to the sales of 8, 41 and 37 Chenies Court. The appellants' statement of case did not dispute this figure and accordingly in his expert report to this Tribunal Mr Nesbitt did not explain his valuation in detail since he assumed that the figure was agreed.

13. In the weeks leading up to the hearing Mr Mallory submitted documents which indicated that the long lease value of £145,000 was no longer agreed because he had become aware of four other transactions within Woodhall Farm which he said suggested that the figure was incorrect. At the hearing, Mr Mallory said that the appellants considered that the long lease value of each flat was £143,036, on an unimproved basis, although went on to say that a deduction for improvements for a flat held on a long lease should be £10,000, rather than £6,500, which would result in a value of £139,536.

14. We concluded that we might be assisted by considering the four transactions to which Mr Mallory referred since Land Registry entries were available, the transactions were not disputed as matters of fact, and Mr Nesbitt had had the opportunity to prepare further calculations based upon these four further transactions. Accordingly, we allowed the inclusion of this late evidence whilst noting Mr Gallagher's submission that there was in fact no expert evidence from the appellants as to value.

15. The available transactions to assist in the valuation of the appeal flats on a long lease basis therefore were therefore as follows:

<u>Flat</u>	<u>Date of Transaction</u>	<u>Price</u>
25 Chenies Court	30 January 2014	£134,950
11 Chenies Court	7 February 2014	£138,000
42 Chenies Court	14 February 2014	£124,500
12 Datchet Close	4 June 2014	£140,000
8 Chenies Court	14 November 2014	£149,500

41 Chenies Court	2 March 2015	£145,000
37 Chenies Court	19 May 2015	£160,000

16. Mr Mallory objected to the inclusion of the sale of 37 Chenies Court since the transaction occurred after the statutory valuation date. He also considered the transaction to be an “outlier”, in a different block to the appeal flats, and he submitted that the price included a share of the freehold interest.

17. We note and endorse the observations of the Deputy President who, in granting permission to appeal, noted that:

“The first-tier tribunal was entitled to have regard to the sale of 37 Chenies Court despite the fact that the transaction completed a month or so after the valuation date. Although the valuation date is fixed, events occurring after that date may be relied on as evidence of values on that date (subject to any appropriate adjustment). The FTT inspected the three blocks of flats and was able to make an assessment of how comparable they were. The FTT noted that 37 Chenies Court had a value considerably above the other comparables available and gave appropriate consideration to whether this might be attributable to the fact that it was sold with a share of the freehold.”

18. Mr Mallory also submitted that the values achieved for 25, 42 and 41 Chenies Court included in each case a share of the freehold interest which had inflated each value. Mr Nesbitt’s evidence, which we accept, was that in his experience a share of the freehold would make little difference to value when considering long lease values. We note that that would appear to be supported by the evidence (after adjusting for dates of sale) of the price achieved for 11 Chenies Court, which was higher than the prices achieved for these three properties even though 11 Chenies Court did not include a share of the freehold interest.

19. In considering relativity and the value of short leases in his expert report, which we consider below, Mr Nesbitt used two House Price Indices to make adjustments to reflect changing market conditions over time. These were the Land Registry Index for flats in Hertfordshire, for which he submitted index figures on a monthly basis, and also the Nationwide Building Society house price index for the outer Metropolitan area. We prefer the Land Registry Index since monthly data points are available to us, and have used it to adjust the table of evidence above. The index figure for May 2015 was not available to us, but even if we assume nil growth between April and May 2015 (which is doubtful but would work in the appellants’ favour), the adjusted sale prices, compared with the index figure at the Valuation Date of 374.14, would be as follows:

<u>Flat</u>	<u>Date of Transaction</u>	<u>Price</u>	<u>Index</u>	<u>Adjusted Price</u>
25 Chenies Court	30 January 2014	£134,950	322.08	£156,763

11 Chenies Court	7 February 2014	£138,000	323.65	£159,528
42 Chenies Court	14 February 2014	£124,500	323.65	£143,922
12 Datchet Close	4 June 2014	£140,000	341.40	£153,426
8 Chenies Court	14 November 2014	£149,500	358.28	£156,118
41 Chenies Court	2 March 2015	£145,000	371.74	£145,936
37 Chenies Court	19 May 2015	£160,000	374.14	£160,000

20. It follows from the above that the average adjusted value, before any deduction for improvements, is £153,670, assuming no growth between April and May 2015. If the sale of 37 Chenies Court is completely excluded, as the appellants maintain it should be, the average value would be £152,615 or thereabouts.

21. There must then be a deduction for improvements. Mr Nesbitt had adopted a deduction of £6,500 in each case and did not consider that this should be any different for short lease flats in comparison with those with long leases. Mr Mallory said that the deduction for long leases should be more in the order of £10,000. He submitted a quote which he said related to the cost of work to bring 10 Chenies Court up to the condition of that of 37 Chenies Court – which amounted to £26,900. But he accepted that cost was not equal to value.

22. In the absence of any expert evidence from the appellants as to an appropriate deduction, we prefer Mr Nesbitt’s evidence, and have adopted a deduction of £6,500 for improvements throughout. The result of this is that the transactional evidence, adjusted for improvements, points to an average of £147,170, or £146,115 if 37 Chenies Court is excluded as the appellants maintain. Other indices might show slightly different figures, but on the basis of our example calculations we are satisfied that Mr Nesbitt’s figure of £145,000 is correct, and we adopt it.

The short lease relativity

Evidence and submissions

23. This issue goes to the heart of the dispute between the parties, and can be summarised as a “market evidence v relativity graphs” point.

24. Mr Mallory submitted that given the low number of comparable transactions that were available, a valuation of the short leases by way of comparables was inappropriate and that instead a combination of relativity graphs should be used.

25. Mr Mallory referred to the 2009 RICS Research Report: “Leasehold Reform: Graphs of Relativity”¹ (to which Mr Nesbitt was a contributor). He submitted that an average figure

¹ <http://www.rics.org/Global/leasehold-reform-graphs-of-relativity.pdf>

derived from the graphs for Greater London and England², together with the published research³ would result in a relativity of 86% for an unexpired term of 57.68 years. He then combined this with the “John D Wood & Co (1996) and Gerald Eve” graph (which he said showed a relativity of 79.5%) to arrive at an average relativity of 82.75% which he said gave a fair reflection of no-Act rights.

26. He submitted that whilst it was difficult to perform a valuation exercise where the “no Act world” had to be imagined, the use of graphs had been endorsed by the Tribunal in *Re Coolrace and Ors* [2012] UKUT 69 (LC), in which the LEASE Graph was used as the basis for a relativity calculation.

27. Mr Mallory, assuming a long lease value of £145,000 and relativity of 82.75%, calculated that a premium of £17,250 would be arrived at. In his oral submissions, he requested that the Tribunal carry out its own calculation based on an unimproved long lease value of £139,536, and a relativity of 82.75%.

28. Mr Mallory also made submissions in respect of agreements to restructure the leases of 11 Chenies Court, which he said was at a premium of £13,750, and 9 Chenies Court, at £15,926, both of which he said were at significantly lower premiums than that being asked of him and the other appellants.

29. Mr Nesbitt’s method of calculating relativity was by reference to comparable evidence. He relied upon two short lease transactions and, as a cross-check, the acquisition by Mr Mallory of 7 Chenies Court.

30. In respect of the short lease transactions, Mr Nesbitt relied upon the sale of Flat 3 Chenies Court, at £120,000 on 17 April 2015, at which point the unexpired lease term was 57.69 years. Flat 2 Datchet Close sold on 6 February 2015 at £127,000, with 57.88 years remaining on the lease. The unexpired term in each case was very similar to that of the appeal flats, at 57.68 years, and he therefore made no adjustment for this. He considered both properties to be comparable to the appeal flats, with a similar level of improvements, and he therefore reduced the average sale price of the two comparable sales, at £123,500, by £6,500 to arrive at an average unimproved sale price of £117,000.

31. He then considered the appropriate deduction for Act rights. The Savills (2002) “enfranchiseable” graph – i.e. with Act rights - showed a relativity of 84.3% for an unexpired term of 57.68 years. The Gerald Eve (1996) graph – without Act rights – indicated a relativity of 79.6% for the same term. This was a reduction of 4.7% in absolute terms, or a relative reduction of 5.5%, which Mr Nesbitt adopted. Applying this to the unimproved value of £117,000, Mr Nesbitt arrived at an unimproved, without Act rights, figure of £110,565. This represented a relativity figure of 76.2% against the long leasehold/freehold value of £145,000.

² Comprising the graphs submitted to the Report by Beckett and Kay, South East Leasehold, Nesbitt and Co, Austin Gray, and Andrew Pridell Associates Ltd

³ Graphs produced as a result of research by the College of Estate Management, Savills, and the Leasehold Advisory Service

32. As a cross check, Mr Nesbitt relied upon the acquisition of 7 Chenies Court, Mr Mallory's property, on 15 June 2012 at £85,000, at which point there were 60.53 years unexpired on the lease. Whilst Mr Mallory considered that he had bought at a bargain price, Mr Nesbitt considered the sale to be an open market transaction. For consistency, he reduced the sale price by £6,500 for improvements, which resulted in a value of £78,500.

33. To adjust for time, and changing market conditions, between June 2012 and the valuation date of April 2015, Mr Nesbitt considered two house price indices. The Land Registry index for flats in Hertfordshire indicated an increase in values over the period of 23%. The Nationwide Building Society index showed an increase of 26.72%. Mr Nesbitt therefore adopted an assumed price increase of 25% which, when applied to his unimproved value of £78,500, showed a notional short leasehold value of £93,750. Mr Nesbitt considered that this "endorsed" his value of £110,565 (as the lower £93,750 would produce a higher marriage value than that which he had calculated).

34. Mr Nesbitt said that the use of graphs was only appropriate in the absence of market evidence, since there were shortcomings in the graphs. Had there been no available evidence, he would have relied upon his own firm's graph (featured in the RICS report) which indicated a relativity of 81.25% for an unexpired term of 57.68 years. This would represent an existing lease value of £117,813. He went on to explain that his firm's graph was based upon over 250 cases, predominantly for flats, over a wide geographical area, between 1995 and November 2008. They included settlements under the Act, and LVT decisions. During that period short leasehold sales were more prevalent than in recent times, so that it was not necessary to resort to relativity graphs.

35. Mr Nesbitt said that during this period he acted for Landlords in over 80% of his cases, and he was able to apply the agreed relativity rate in subsequent claims within the same block of flats or on estates, but as the lease length dropped below 55 years, the relativity ranged considerably in the various blocks. He therefore did not attempt to standardise below this length of term, but instead sought fresh sales evidence or followed settlements within that particular block. In cases where the evidence derived from sales was adopted by the LVT, that decision would then be applied to many subsequent settlements, and his graph would then reflect that.

36. In this case, Mr Nesbitt said that it would be wrong to ignore transactional evidence within the same blocks as the appeal flats, and instead adopt a relativity by reference to a graph, the underlying data of which might be based upon a series of settlements in far locations.

37. He also considered that there was a fundamental deficiency in the relativity graphs, in that they appeared to show that short leases were more expensive in outer London than in Prime Central London, whereas the opposite was the case. In Prime Central London the market was stronger, and featured buyers who were not generally mortgage dependent. Additionally, some of the graphs were based upon opinion, rather than transactional evidence.

Discussion and conclusions

38. Mr Mallory relied upon two series of graphs. The first series had been collected under the heading “Greater London and England” in the RICS Research Report. We have outlined above Mr Nesbitt’s comments on the limitation of his own firm’s graph. Of the others, the Beckett and Kay graph was based upon that firm’s opinions of relativity; the South East Leasehold graph was primarily based upon transactions in Bromley and Beckenham; the Austin Gray graph was based upon transactions primarily in Brighton and Hove; and the Andrew Pridell and Associates graph was based on a mixture of opinion, settlements, transactions, LVT and Lands Tribunal decisions. We do not consider that any of these provide a more reliable guide to relativity than transactions in the same scheme as the appeal properties.

39. Mr Mallory’s second series comprised the “published research” section of the RICS Report. Of these, the College of Estate Management comprised only LVT decisions, and was the subject of criticism by the Tribunal in *The Trustees of the Sloane Stanley Estate & Anor v Mundy & Ors* [2016] UKUT 223 (LC) (para 67 of Appendix C) to the effect that no valuer used the graph in negotiations and that the researchers accepted that LVT decisions may not always produce a correct valuation. We agree with the Tribunal’s dismissal of that graph. Similar reservations can be levelled at the Leasehold Advisory Service graph, which again comprised solely LVT decisions. The remaining graph is the Savills 2002 graph, which Mr Nesbitt has also used. We derive no assistance from the CEM or Leasehold Advisory Service graphs.

40. We remind ourselves of the findings of the Tribunal (Morgan J and Mr Trott FRICS) in *Sloane Stanley* where (at 168) the Tribunal gave guidance in respect of future cases:

“...in some (perhaps many) cases in the future, it is likely that there will have been a market transaction at around the valuation date in respect of the existing lease with rights under the 1993 Act. If the price paid for that market transaction was a true reflection of market value for that interest, then that market value will be a very useful starting point for determining the value of the existing lease without rights under the 1993 Act. It will normally be possible for an experienced valuer to express an independent opinion as to the amount of the deduction which would be appropriate to reflect the statutory hypothesis that the existing lease does not have rights under the 1993 Act.”

41. The Tribunal went on to say (at 169) that:

“...the more difficult cases in the future are likely to be those where there was no reliable market transaction concerning the existing lease with rights under the 1993 Act, at or near the valuation date. In such a case, valuers will need to consider adopting more than one approach. One possible method is to use the most reliable graph for determining the relative value of an existing lease without rights under the 1993 Act. Another method is to use a graph to determine the relative value of an existing lease with rights under the 1993 Act and then to make a deduction from that value to reflect the absence of those rights on the statutory hypothesis. When those methods throw up different figures, it will then be for the good sense of the experienced valuer to determine what figure best reflects the strengths and weaknesses of the two methods which have been used.”

42. We endorse and reiterate the Tribunal's preference for market evidence over the use of relativity graphs, as long as it can be shown that the market evidence is reasonably comparable and does not require artificially extensive manipulation in order to apply it to the subject valuation.

43. In this case, we are satisfied that there is sufficient market evidence to render unnecessary any reference to graphs of relativity. Not only is there a market transaction on one of the appeal flats, there are also, fortuitously, two market transactions on very similar properties with virtually identical unexpired terms to that required to be assumed for the calculation on the appeal flats. We consider that Mr Nesbitt was right to prefer the two comparable sales to the historic sale of one of the appeal properties, which required an adjustment for time by reference to indices. In fact, there may be some merit in Mr Mallory's assertion that he bought the property at a bargain price. Had the price of £85,000 been subject to an upwards adjustment, Mr Nesbitt's £93,750 would have been closer to his £110,565 arrived at by reference to the two comparable sales.

44. Whilst we have some doubt that it is correct to apply a blanket £6,500 deduction in each and every case, there was no evidence from the appellants to refute this. As regards Mr Nesbitt's deduction of 5.5% for Act rights, Mr Gallagher, in our view accurately, described this as "unimpeachably modest". We note that it is consistent (in respect of an unexpired term of 57.68 years) with the Tribunal's findings in *Sloane Stanley* of deductions of 10% for an unexpired term of 37 years (para 152), and 20% for 23 years (para 158), although we would stress that each case must be considered on its merits and be based on the evidence available.

45. We have not derived any assistance from the two settlement premiums which Mr Mallory referred to. In the case of 11 Chenies Court, the transaction is not comparable to the subject cases. The lease was extended, by agreement, for 40 years, and involved a ground rent which was to be subject to fixed increases. In the subject valuations, we are to assume a new 90-year extension at a peppercorn. As regards 2 Datchet Close, there was insufficient background evidence to enable us to attach any weight to the transaction.

46. For the reasons outlined above, we prefer Mr Nesbitt's method and calculations to those of Mr Mallory. We have therefore adopted Mr Nesbitt's short lease value, unimproved and without Act rights, of £110,565.

Conclusion

47. We determine that the premium payable for the extended lease in each case to be £21,908. The Tribunal's valuation is attached as an appendix.

Dated: 2 November 2016

His Honour Judge David Hodge QC

A handwritten signature in black ink, appearing to read 'Peter D McCrea', with a stylized, flowing script.

Peter D McCrea FRICS

LRA/7/2016									
7 Chenies Court, 10 Chenies Court, and 30 Datchet Close, Hemel Hempstead									
Upper Tribunal's Valuation in each case									