LON/LVT/2043/06

**LEASEHOLD VALUATION TRIBUNAL FOR THE RESIDENTIAL PROPERTY TRIBUNAL SERVICE**

**DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR AN APPLICATION UNDER SECTION 21 OF THE LEASEHOLD REFORM ACT 1967**

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| **APPLICANT:** | Joyce A Adams |
| **RESPONDENT:** | Martin William Ward |
| **PREMISES:** | 10 Broom Park & Garage 18, Teddington TW11 9RN |
| **Date of Tenant's Notice:** | 3 August 2005 |
| **Date of Counter Notice:** | 7 November 2005 |
| **Application Date:** | 21 March 2006 |
| **Hearing Date:** | 22 & 23 August 2006 |
| **Appearance for the Applicant:** | Mr C Witts – Christopher Witts & Partners |
| **Appearance for the Respondent:** | Mr M W Ward – Landlord<br>Mr D Greenish – Pemberton Greenish<br>Mr H Ailes – J C Francis & Partners Ltd |

**Members of the Leasehold Valuation Tribunal:**

Mr I Mohabir LLB(Hons)
Mrs H C Bowers BSc(Econ) MSc MRICS
Mrs L Walter MA(Hons)

**Date of Decision:** 18 January 2006

**IN THE LEASEHOLD VALUATION TRIBUNAL**

**LON/LVT/2043/06**

**IN THE MATTER OF 10 BROOM PARK & GARAGE 18, TEDDINGTON, TWII 9RN**

**AND IN THE MATTER OF THE LEASEHOLD REFORM ACT 1967 (AS AMENDED)**

**BETWEEN:**

**JOYCE ANNE ADAMS**

**Applicant**

**-and-**

**MARTIN WILLIAM TOTTERDELL WARD**

**Respondent**

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**THE TRIBUNAL'S DECISION**

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**Background**

1. This is an application made by the Applicant pursuant to s.21 of the Leasehold Reform Act 1967 (as amended) ("the Act") for a determination of the price to be paid to the Applicant to acquire the freehold interest in the property known as 10 Broom Park and Garage 18, Teddington, TW11 9RN ("the subject property").

2. It was common ground that the purchase price payable by the Applicant was to be valued in accordance with s.9(1) of the Act and on the assumptions

contained therein. The Tribunal does not intend to set out here the detailed statutory provisions that apply in relation to the valuation of the freehold interest, as both parties in this matter had the benefit of professional advice and representation throughout.

3. The Tribunal was informed that the following facts had been agreed:

(a) the valuation date is 3 August 2005, being the date of the Applicant's Notice of Claim.

(b) the relevant lease is dated 2 April 1970 and granted for a term of 120 years from 25 December 1968. The unexpired term as at the valuation date was 83.39 years. The ground rent is £60 fixed for the unexpired term.

(c) the site value is £392,000.

4. The matters that still remained in issue were:

(a) the appropriate rate to be applied to capitalise the ground rent.

(b) the appropriate rate to be applied to the deferment of the reversionary interest.

(c) whether a "Haresign addition" should be applied in this instance. In the event that the Tribunal found this to be appropriate, the value of the freehold vacant possession interest in the subject property was agreed at £643,500.

Each of these matters is considered in turn below.

**Inspection**

5. The Tribunal inspected the subject property on 23 August 2006. The subject property is a semi-detached house built in approximately the late 1960's. The house is of brick construction with some cladding, under a flat roof. The accommodation comprises two reception rooms, a kitchen and a cloakroom on the ground floor and three bedrooms, one with an en-suite bathroom and a family bathroom on the first floor. There is a small courtyard garden to the front and a small garden to the rear of the house. The garden at the rear leads onto an open area with frontage onto the River Thames. The subject plot is attractive but is situated within a large development of similar aged properties. A garage is located in a block of garages, quite close to the house.

**Hearing**

6. The hearing in this matter also took place on 23 August 2006. The Applicant was represented by Mr Witts, a Chartered Surveyor. The Respondent was represented by Mr Greenish from the firm of Pemberton Greenish, solicitors.

7. As to the rate to be applied to the capitalisation and deferment rates, Mr Witts simply submitted that these should be 8% and 7% respectively. This was on the based on customary yield rates adopted in recent times and on his own personal experience of settlements reached with other valuers acting for freeholders. Mr Witts informed the Tribunal that in the previous week he had agreed a lease extension where yield rates of 8% and 8.5% had been reached. However, he provided no further details or evidence about this settlement.

8. As to the Haresign addition contended for by the Respondent, Mr Witts again simply submitted that it had no application in this matter. He gave no reason for reaching this conclusion other than "an old fashioned approach" had been adopted by him. In conclusion, he submitted that the purchase price for the freehold should be £2,121 as set out in the valuation at page 8 of his expert report dated 16 August 2006 (as amended at the hearing).

9. By way of opening, Mr Greenish reminded the Tribunal of the conclusions reached by the Lands Tribunal in the consolidated appeals heard together with ***Arbib v Earl of Cadogan*** [2005] ***("Arbib")*** and the approach to be taken generally in relation to yields and, in particular, deferment rates. The Lands Tribunal concluded, *inter alia*, at paragraph 180 of the judgement that:

(a) a convention of historic deferment rates adopted should not be used.

(b) that earlier decisions of LVTs and the Lands Tribunal should not be regarded as evidence of value in later cases nor do they establish any conventions or precedents as to value.

(c) that market evidence is unlikely to be dependable as they probably do not take place in a "no Act" world.

(d) in the absence of dependable market transactions, it was permissible to refer to the money markets in order to assess deferment rates.

Mr Greenish submitted that the same approach taken by the Lands Tribunal in ***Arbib*** in relation to deferment rates could also be applied when assessing capitalisation rates. He further submitted that no market evidence at all had

been adduced by Mr Witts, on behalf of the Applicant, and the Tribunal was therefore required to have regard to the money markets and, in particular, the valuation prepared by the Respondent, having regard to the prevailing gilt rates as at the valuation date. In relation to the Haresign addition, Mr Greenish accepted that this was purely a matter of valuation evidence, which valued the reversion on the expiration of the term of the lease. He further accepted that there was nothing within the statute that required or prohibited its inclusion.

10. The first witness called on behalf of the Respondent was Mr Ailes, a Chartered Surveyor and Director in the firm of J C Francis and Partners Ltd. He had earlier prepared a report dated 10 August 2006, which dealt solely with the capital value of the house and the site. However, in view of the agreement subsequently reached with Mr Witts about the site value, his evidence to the Tribunal was confined to the appropriateness of the Haresign addition in valuing the reversion. He also confirmed that the statute gave no guidance on this matter and that it was simply a matter of valuation.

11. Mr Ailes contended that the Haresign addition should be made in this instance because of the unique location and architecture of the subject property. As a result, it might become listed at some time in the future. In addition, the property could be pulled down and redeveloped. The Haresign addition should become a more frequent feature in valuations under the 1967 Act.

12. In cross-examination, Mr Ailes conceded that the valuation approach adopted by Mr Witts generally was still being used in practice. He also conceded that he had never agreed a Haresign addition in relation to any other property he had dealt with. However, he qualified this by stating that no other property had occupies such a unique location as the subject property.

13. The Respondent, Mr Ward, then gave evidence on his own behalf as a financial expert. As such, he accepted that he was not an independent expert. He stated that he was a Chartered Certified Accountant by training and that his evidence was limited to the appropriate rates to be applied to capitalise the ground rent and to the deferment of the reversion. Mr Ward had prepared a report dated 18 August 2006 setting out in detail his analysis of the appropriate capitalisation and deferment rates that should be applied in this matter. In the course of his evidence, Mr Ward spoke to this document. In his opening, Mr Greenish submitted that there was no reason to consider the determination of either rate differently.

14. Mr Ward stated that the ground rent should be capitalised at a rate of 4.26%, being the redemption yield of Treasury 4.25% 2055 stock. This was the nearest equivalent maturity nominal UK government gilt in issue on the valuation date. There was, in effect, little or no risk of tenants defaulting in paying the ground rent as it was well secured against the property on any future lease assignment. This low risk was appropriately reflected in the yield rate adopted by him.

15. As to the deferment rate, Mr Ward relied almost exclusively on the valuation approach taken by the Lands Tribunal in ***Arbib*** for the reasons set out by Mr Greenish in opening. There was no convention as to rates nor could settlement evidence be relied upon because it largely no longer took place in a "no Act" world and was, therefore flawed. In the absence of such reliable evidence, resort had to be made to the money markets and, in particular, gilt rates. In addition, earlier LVT decisions on deferment rates should not be treated as evidence of value in later cases. The LVT had to make a determination in each case based on the evidence adduced by the parties.

16. Mr Ward's evidence was that the appropriate deferment rate could be determined by ascertaining the ***risk free rate*** to which was added a ***risk premium*** and then a deduction was made for growth. The effect of inflation was excluded when each element was determined to ensure that the "real" rate was adopted. This was the approach adopted by the Lands Tribunal in ***Arbib***.

17. The risk free rate was the rate to be applied on the basis that there was no risk at all involved and best represented by index-linked gilts. He stated that the "real" risk free that should be adopted was 1.47%, being the redemption yield of the British government's longest maturity index-linked gilt, Index Linked 2% 2035 stock. Mr Ward then adjusted this figure downwards by 20 points (0.2%) to 1.27% to reflect the "inverse yield curve" which existed as at the valuation date. He explained that this existed when long term debt instruments have lower yields than short term debt instruments.

18. As to the risk premium, Mr Ward's evidence was largely heresay. He relied almost exclusively on the evidence given by Mr Clokey, a Chartered Account and financial expert, to the Lands Tribunal in ***Arbib***. Mr Clokey had explained that the risk free premium was the additional return above the risk free rate required to compensate the investor for the risk of investment. The greater the risk, the greater the compensation. The risk run by a freeholder was the freehold capital value upon expiry of the term of the lease. Mr Clokey's opinion was that the risk of a residential freehold reversion lay somewhere between government bonds and equities in general. This was because residential properties in general were less volatile than equities and have a low correlation with equities.

19. Mr Clokey went on to say that the risk premium could be determined by using the Capital Asset Pricing Model ("CAPM"). This was a tool used for assessing discount rates and the cost of capital in corporate valuation, regulation and fund management. It is also frequently applied to equity investments, but could be applied to any asset, including freehold reversionary assets. The CAPM involved, firstly, ascertaining the "equity risk premium" (4.5% in the UK) and then applying a "beta" figure to this. The beta figure represents the level of risk involved in any given asset. Average risk is represented by a beta figure of 1. An asset with a higher risk will have a beta figure greater than 1 and vice versa. Mr Clokey's view was that reversionary interests had a beta figure somewhere between 0.3 and 0.5, which produced a risk premium of 1.8%. When added to the risk free rate of 1.27%, it provided

an overall rate of 3.07%, which Mr Ward contended should be the deferment rate adopted by the Tribunal in this instance.

20. At paragraphs 35-43 of his report, Mr Ward discusses at some length the reasons why, in his opinion, no distinction should be made on deferment rates for properties located outside prime central London areas in a "no Act" world. Mr Ward then goes on to set out the evidence given by the various experts to the Lands Tribunal in ***Arbib*** that supported this proposition. It is not necessary to set these matters out here. In the concluding paragraphs of his report, Mr Ward makes no further deductions for growth, illiquidity or the assumption that an assured shorthold tenancy will arise upon expiry of the lease.

**Decision**

21. Although the judgement of the Lands Tribunal in the ***Arbib*** appeals, on the facts, is confined to the determination of deferment rates, this Tribunal accepted the submission made by Mr Greenish that the approach to determining the capitalisation rate ought not to be treated differently, in so far as it should be evidence led. However, the Tribunal's consideration of the rate to be applied to the ground rent is not limited to the approach taken by the Lands Tribunal in ***Arbib*** and subsequently in the judgement given in ***Earl Cadogan & Cadogan Estates Ltd v Sportelli & Sportelli*** [2006] ("***Sportelli***") in relation to deferment rates generally. Both capitalisation and deferment rates were considered separately by the Tribunal.

**(a) Capitalisation Rate**

22. Mr Witts had contended for a rate of 8% based on what he regarded as "customary". He accepted, at paragraph 3.12 of his report, that there was little market evidence on which he could support this figure. Although at the hearing Mr Witts told the Tribunal that in the preceding week he had reached a settlement in relation to a lease extension for another property, he had not provided any evidence to support this assertion. His valuation approach was precisely the approach disapproved of by the Lands Tribunal in ***Arbib***. It appeared to adopt a convention of 8%, which was unsupported by any reliable market evidence neither was it no longer appropriate to rely on settlement evidence. Generally, the Tribunal was of the view that the valuation evidence provided by Mr Witts in this matter provided it with little or no assistance. The Tribunal concluded that it could place no reliance on the figure of 8% contended for by him.

23. Conversely, the Tribunal found Mr Ward to be a credible and knowledgeable witness. However, as was conceded by him, he appeared as his own expert witness and his evidence was not independent. The Tribunal, therefore, treated his evidence with some degree of caution. Nevertheless, in the absence of any other evidence, the Tribunal accepted as a starting point his figure of 4.26% for the capitalisation rate. This would reflect the low risk of recovery for the ground rent and that it was well secured against the property but Mr Ward's sole reliance on this gilt rate seems to ignore other considerations in

relation to property investments, which differ from a purely financial investment and have a bearing on the rate.

24. The Tribunal considered that management costs were relevant. The ground rent under this lease is fixed at £60 per annum collected twice yearly. This would prove unattractive to an investor, as the amount collected would almost certainly be extinguished by the costs of collection. Current legislation requires landlords to serve a demand first of all before the collection of ground rents can take place. The cost of doing so would have a significant impact on the net rental income, especially if there is a low fixed ground rent as there is here. Despite, Mr Ward's assertion that the lease terms require a tenant to pay the ground rent and that he has encountered no problems in this regard (so far), nevertheless, the ***risk*** of such default occurring and the cost of recovering such a small ground rent should be reflected in the addition of a further 1.25%.

25. The Tribunal also considered that illiquidity and transaction costs were relevant to not only capitalisation but deferment rates also. A financial asset can be transferred or sold fairly quickly with little or no inherent cost whereas the disposal of a property asset invariably involves significantly greater costs and delay: see para. 151 of ***Arbib***. Inevitably, this must have an adverse affect on the yield rate overall. The Tribunal was of the view that this should properly be reflected by the addition of a further 1%. Accordingly, the Tribunal finds that the appropriate rate to capitalise the ground rent is 6.5%.

**(b) Deferment Rate**

26. The 7% contended for by Mr Witts was rejected by the Tribunal for the same reasons set out above. Having regard to the recent judgement of the Lands Tribunal in ***Sportelli***, the Tribunal was of the view that the valuation approach adopted by Mr Ward in relation to ascertaining the deferment rate was correct in principle. Whilst the Lands Tribunal in ***Sportelli*** approved of the CAPM valuation approach in so far as it adopted a risk free rate, minus the real growth, it expressly disapproved of the indexation of risk using a Beta factor, as advocated by Mr Clokey and relied upon by Mr Ward. Indeed, the Lands Tribunal heard evidence from Mr Clokey on this matter in ***Sportelli*** and rejected the use of a Beta factor on the basis that it produced widely differing results depending on which Beta factor was adopted. Instead, the Lands Tribunal considered that there had to be an independent assessment of the risk premium. This was the approach taken by Professor Lizieri, Professor of Real Estate Finance at the University of Reading, who also gave evidence to the Tribunal in ***Sportelli*** and upon whom Mr Ward places great reliance in this matter. The Tribunal, therefore, adopted the same approach in determining the appropriate deferment rate.

27. In the absence of any other evidence, the Tribunal accepted Mr Ward's evidence that the risk free rate should be 1.27%. The Tribunal considered the deduction of 0.2% made by him from the rate of 1.47% for the Index Linked 2% 2035 stock as being properly made having regard to the prevailing spot rate as at the valuation date. It is also perhaps material that Mr Ward did not later seek to make a further deduction for real growth in his valuation

otherwise the Tribunal would have adopted a rate of 2.25%, given that deferment rates now appear to have universal application.

28. As to the risk premium, the valuation approach adopted by Mr Ward has been rejected by the Lands Tribunal in ***Sportelli***. This assessment must now be made independently without reference to any Beta factor. It follows that the Tribunal did not accept Mr Ward's figure of 1.8% for the risk premium. In ***Sportelli***, the Lands Tribunal said that this had to be determined by considering various individual risks associated with long term reversions. The risks included volatility, illiquidity, deterioration and obsolescence. This would enable an overall assessment of the premium that would be required by investors for the asset under consideration. The Tribunal went on to say that physical deterioration and obsolescence need to be reflected in the generic deferment rate to the extent that the risk is common to all residential property in the long term. It is volatility and illiquidity that have the major impact on the risk premium.

29. At the time this matter was heard, the Lands Tribunal judgement in ***Sportelli*** had not been handed down and was not argued by the parties before the Tribunal. It, therefore, considered that it was appropriate that they should have an opportunity to make written submissions specifically on the deferment rate to be applied to the reversionary interest. Those written submissions are dated 1 December 2006 and 28 November 2006 respectively.

30. It was submitted on behalf of the Applicant that the Tribunal should find for a rate of 4.75% in accordance with the decision in ***Sportelli***. It was, correctly, submitted on behalf of the Respondent that the Tribunal must determine the issue of the appropriate deferment rate to be applied on the basis of the evidence before it: see ***Arrowdell v Coniston Court*** (LRA/72/2005). It was further submitted that the evidence of the Respondent supported a rate of 3.07% and that the Tribunal should find in these terms.

31. The Tribunal did not accept the submission made on behalf of the Respondent that, on the basis of the evidence as to yield rates, it was bound to find that a deferment rate of 3.07% should be adopted in this instance. In a tightly and carefully worded judgement the Lands Tribunal in ***Sportelli*** found that a generic deferment rate of 4.75% should be applied in relation to houses. This finding had been reached having considered and mainly accepted the valuation evidence of Professor Lizieri in those appeals. This approach was largely followed by the Respondent in this matter. Whilst the Lands Tribunal accepted in principle that the deferment rate of 4.75% may be subject to adjustment, it would only be open to a Tribunal to interfere with that rate where it was satisfied that there were particular features that fall outside the matters that are reflected in the vacant possession value of the house or flat or in the deferment rate itself and can be shown to make a departure from the rate appropriate. The Lands Tribunal carefully went on to expressly set out various special factors that would, exceptionally, allow a Tribunal to interfere with the deferment rate of 4.75% applicable to houses. On the basis of the evidence before it, and in particular that of the Respondent, none of those

special factors exist in this matter. This was conceded in paragraph 15 of the Respondent's written submissions. The Respondent's evidence that a lower spot yield rate may have existed as at the valuation date is irrelevant. The Lands Tribunal figure of 4.75% was arrived at on the basis that it properly represented a suitable long-term rate for houses having regard to average annual real growth and the attraction of the relative security of this type of investment. The Tribunal also saw no merit in the Respondent's submission that the unexpired term of more than 75 years supported the rate of 3.07% contended for by him. There was simply no basis for making this assertion. It was not supported by any other evidence. At stated earlier, the Respondent gave evidence on his own behalf, which was not independent and self-serving. Where it was relied on, it was treated by the Tribunal with some caution. In ***Sportelli***, the Lands Tribunal specifically considered, as a special factor, the length of the unexpired term of a lease and concluded that in all circumstances the deferment rate was constant beyond 20 years. This finding was unqualified. The Tribunal concluded that it was bound by the decision in ***Sportelli*** and that the evidence in this matter did not allow it to determine that the appropriate deferment rate to be applied is 4.75%.

**(c) Haresign Addition**

32. The Tribunal saw no merit in this argument advanced on behalf of the Respondent and, indeed, Mr Greenish did not argue strongly in favour of it. As Mr Greenish is well aware, it is not usually the case to attribute a separate value to the landlord's ultimate reversion. At the end of the lease term, a property is likely to be old and the only value will be in the site value. In the

Lands Tribunal case of ***Re: Marlodge (Monnow) Ltd*** (LRA/28/2002) (unreported), P H Clarke FRICS said that a Haresign addition would only be appropriate in exceptional circumstances and, in the Tribunal's view, those circumstances did not exist here. The evidence given by Mr Ailes was, at its highest, speculative and was based entirely on the unique location of the property and the value of that unique location is reflected in the site value. The test to be applied would be if the subject property (and not the location) would remain standing ***and*** be of value at the end of the 50-year extension. On balance, the Tribunal was satisfied that this evidential burden had not been met by the Respondent.

33. Accordingly, for the reasons stated above, the Tribunal determined that the price to be paid by the Applicant for the freehold interest in the subject property is **£9,100**. The Tribunal's valuation is annexed to this Decision.

Dated the 18 day of January 2007

CHAIRMAN..... I Mohabir .....

Mr I Mohabir LLB (Hons)

Appendix

**10 Broom Park Teddington**

| | | | |
|---|---|---|---|
| Landlord's Present Interest | | | |
| Term | | | |
| Rent | | £60 | |
| YP 83.39yrs @ 6.5% | | 15.30395 | |
| | | | £918 |
| | | | |
| Reversion to Capital Value | | | |
| Site Value | | £392,000 | |
| | | | |
| Modern Ground Rent @ 4.75% | | £18,620 | |
| | | | |
| YP in perp @ 4.75% | 21.05263 | | |
| PV of £1 in 83.39 years @ 4.75' | 0.0208673 | | |
| | | 0.43931 | |
| | | | £8,180 |
| | | | £9,098 |
| | | | |
| **Premium Payable** | | | **£9,100** |