

SOUTHERN RENT ASSESSMENT PANEL
LEASEHOLD VALUATION TRIBUNAL

Case No. CHI/00MR/OCE/2006/0091

REASONS

Application : Sections 31 of the Landlord and Tenant Act 1987 as amended (“the 1987 Act”)

Applicant/Leaseholders : Alleron Developments Limited (“the Company”) (Flats 1 and 2), and Mr Gideon Andrew Francis Sherwood (Flat 3)

Respondent/Landlord : William Anthony King

Building : 11 Nightingale Road, Southsea, Hants, PO5 3JH

Flats : The four residential Flats in the Building

Date of Portsmouth County Court Order : 15 September 2006

Date of Application to Refer to the Tribunal : 23 November 2006

Date of Directions : 12 December 2006

Date of Hearing : 30 January 2007

Venue : Hearing Room, 1st Floor, 1 Market Avenue, Chichester

Appearances for Applicant/Leaseholders: Mr Victor Ray MRICS, ACBSI, and Mr K Rashid, son of Captain K G Rashid, director of the Company

Appearances for Respondent/Landlord: no attendance or representation

Members of the Leasehold Valuation Tribunal : Mr P R Boardman JP MA LLB (Chairman), Mrs H C Bowers MRICS, and Mr M R Horton FRICS

Date of Tribunal’s Reasons : 21 February 2007

Introduction

1. On the 7 April 2006 the Applicant/Leaseholders issued proceedings in Portsmouth County Court under section 29 of the 1987 Act applying for an order that the Company be entitled to acquire the Respondent/Landlord's interest in the Building. The grounds of the application were set out in the details of claim at pages 16 to 19 of the Tribunal's bundle
2. By an order of the Portsmouth County Court dated the 15 September 2006, the Applicant/Leaseholders' application was granted, and it was ordered that the claim be referred to the Tribunal to determine the terms upon which the Respondent/Landlord's interest was to be acquired
3. On the 12 December 2006 the Tribunal gave directions
4. The hearing of the application took place on the 30 January 2007
5. Section 31 of the 1987 Act provides as follows :

31 Determination of terms by rent assessment committees.

(1) A leasehold valuation tribunal shall have jurisdiction to determine the terms on which the landlord's interest in the premises specified in an acquisition order may be acquired by the nominated person to the extent that those terms have not been determined by agreement between the landlord and either—

- (a) the qualifying tenants in whose favour the order was made, or*
- (b) the nominated person;*

and (subject to subsection (2)) the tribunal shall determine any such terms on the basis of what appears to them to be fair and reasonable.

(2) Where an application is made under this section for the tribunal to determine the consideration payable for the acquisition of a landlord's interest in any premises, the tribunal shall do so by determining an amount equal to the amount which, in their opinion, that interest might be expected to realise if sold on the open market by a willing seller on the appropriate terms and on the assumption that none of the tenants of the landlord of any premises comprised in those premises was buying or seeking to buy that interest.

(3) In subsection (2) "the appropriate terms" means all of the terms to which the acquisition of the landlord's interest in pursuance of the order is to be subject (whether determined by agreement as mentioned in subsection (1) or on an application under this section) apart from those relating to the consideration payable.

(4) On any application under this section the interests of the qualifying tenants in whose favour the acquisition order was made shall be represented by the nominated person, and accordingly the parties to any such application shall not include those tenants.

[...]

(6) Nothing in this section shall be construed as authorising a leasehold valuation tribunal to determine any terms dealing with matters in relation to which provision is made by section 32 or 33.

Documents

6. The documents before the Tribunal are the Application and supporting papers at pages 1 to 80 of the Tribunal's bundle

Inspection

7. The Tribunal inspected the exterior of the Building and the interior of Flats 1 and 2 on the morning of the hearing on the 30 January 2007. Mr Rashid attended the inspection
8. The Building was a 4-storey block, forming part of a terrace apparently built in the 1800's. The basement Flat, numbered 1, was accessed by steps down from the forecourt, and had its own front door. The other 3 Flats were all accessed via a main front door, which itself was accessed by steps up from the forecourt. Each flat had a bay window at the front. The front door was to the right of Flat 2, which Mr Rashid said was on what was known as the "hall floor". Flats 3 and 4 were on the first and second floors respectively. The Building was of brick construction, which was rendered on the front elevation. The windows were double-glazed UPVC. The Building appeared to be in reasonable decorative condition
9. The Tribunal inspected the interior of Flats 1 and 2. They were both 1-bedroomed Flats, with a kitchen, lounge, bathroom, hall cupboard, and central heating. Flat 1 was occupied by a tenant. It had a fully fitted kitchen. Flat 2 appeared to be in the course of refurbishment
10. The Tribunal did not inspect the interior of Flats 3 and 4, but Mr Rashid said that Flat 4 was slightly larger than the other 3 Flats, because there was no stairwell on the second floor
11. The Tribunal also inspected the exterior of 4 other flats in Nightingale Road in the presence of Mr Rashid, in respect of which the Tribunal had noted the following asking prices on the internet:
 - a. Flat 2, 7 Nightingale Road, which appeared to be considerably larger than any of the Flats, where the recorded sale price had been £210,000 in February 2006
 - b. Flat 3, 15 Nightingale Road, which was a first floor flat in a block which appeared to be similar to the Building, where the recorded sale price had been £112,500 in January 2006

- c. 21A Nightingale Road, which was a basement flat in a block which appeared to be similar to the Building, where the recorded sale price had been £110,000 in January 2006
- d. 21C Nightingale Road, which was a second floor flat in a block which appeared to be similar to the Building, where the recorded sale price had been £82,500 in November 2005

Preliminary and procedural matters

12. The Respondent/Landlord did not attend the hearing. Indeed, the Tribunal noted from the papers that the whereabouts of the Respondent/Landlord were unknown. Neither Mr Sherwood, nor the lessee of Flat 4, Michael Leslie Etherington, attended the hearing either.
13. There was no copy before the Tribunal of the Lease of Flat 4, but Mr Rashid stated that it was in materially the same terms as the Leases of Flats 1, 2, and 3. The Tribunal's determination of the consideration for the Respondent/Landlord's interest is based on that assumption.
14. The Tribunal noted at the hearing that section 31 of the 1987 Act did not specify :
 - a. the date at which the consideration for the Respondent/Landlord's interest should be determined ("the relevant date")
 - b. the methodology for that determination
15. In relation to the relevant date, the Tribunal indicated that candidates for the relevant date included the date of the Applicant/Leaseholders' application to the county court, the date of the county court's order referring the matter to the Tribunal, the date of the referral to the Tribunal, and the date of the hearing before the Tribunal. The Tribunal also referred, by way of comparison, to enfranchisement under the Leasehold Reform, Housing and Urban Development Act 1993 ("the 1993 Act"), in respect of which the relevant date was the date of the tenant's initial notice. With the agreement of Mr Ray, the Tribunal adopted as the relevant date in these proceedings the date of the county court's order referring the matter to the Tribunal, namely the 15 September 2006.
16. In relation to methodology, Mr Ray submitted that the only relevant matter which would be taken into account by a buyer in the open market was the capitalisation of the passing ground rent. However, the Tribunal indicated that the Tribunal would also wish to consider evidence and submissions in relation to :
 - a. the value of the right of the buyer to own the freehold reversion with vacant possession at the end of the Leases, and
 - b. the question whether there should be any addition for "hope value" in relation to the possibility that each of the 4 leaseholders might at some time in the future pay the buyer a premium to exercise their rights under the 1993 Act to seek a lease extension
17. Mr Ray agreed that there could be no question of an addition for marriage value, as such,

because :

- a. the wording of section 31 expressly required the Tribunal to assume, in valuing the Respondent/Landlord's interest, that *"none of the tenants of the landlord of any premises comprised in those premises was buying or seeking to buy that interest"*
- b. that assumption necessarily carried with it the further assumptions that :
 - the buyer would be someone other than the present owner of the freehold reversion and the present owners of the Leases
 - there would accordingly be no merger of the two sets of interests for present purposes

18. Mr Ray apologised to the Tribunal that :

- a. his report (pages 4 to 10 of the Tribunal's bundle) had been intended only as a starting point for negotiations with the Respondent/Landlord, and had not been prepared as an expert's report to the Tribunal, as such
- b. he had not submitted a witness statement certified in accordance with RICS requirements

The Leases

19. The Leases of Flats 1, 2, and 3 are copied at pages 54 to 80 of the Tribunal's bundle

20. They are each :

- a. for a term of 99 years from the 25 September 1981, and accordingly had some 74 years left to run
- b. at an annual rent :
 - during the first 25 years of £25
 - during the next 25 years of £50
 - during the next 25 years of £75
 - during the remainder of the term £100
- c. subject to tenant's covenants to maintain the Flat in good and tenantable condition, not to make structural alterations without consent, and to pay annually a one quarter share of the landlord's costs of complying with the landlord's covenants to insure the Building and to repair and maintain and keep the Building in good and substantial repair and condition and to decorate the exterior every 3 years, and of the cost of management of the Building

Mr Ray's report 6 September 2006 (pages 4 to 10 of the Tribunal's bundle)

21. Mr Ray's report was based on an inspection of the exterior of the Building in August 2006. It was on the basis of transactions in the open market. It was submitted in accordance with the rules contained in the RICS Valuation and Appraisal Manual [although Mr Ray subsequently admitted that that was not the case, as recorded in paragraph 18 of these reasons]

22. Mr Ray described the property as comprising a conversion of 4 flats located in a 4-storey building on the east side of Nightingale Road. It was probably built during the late 1800's in brickwork under a pitched tile roof. It formerly comprised a semi-detached private house which was converted probably about 25 years ago into 4 flats. Flat 1 was a semi-basement flat with a rear garden and separate side access. Flat 2 was located on the "hall floor" and had a small, shared forecourt at the front. Flat 3 was on the first floor, and Flat 4 was on the second floor. There was a communal hall with stairs and external access to the semi-basement Flat

23. The exterior had been regularly maintained and was in satisfactory condition. Noise insulation and fire separation had probably not been undertaken as the conversion pre-dated modern requirements

24. Mr Ray understood that all 4 Flats were held on similar long leases. He summarised their terms and covenants as set out earlier in these reasons

25. The Building was located within a reasonably good residential district convenient for city centre amenities

26. Mr Ray's view was that the yield applicable in determining the value of the Respondent/Landlord's interest was 11%

27. A purchaser in the market would expect to pay £1,800 for the freehold interest, calculated as follows, on the assumption that the market would ignore uplift valuations on future rent increases :

rent received (25 years unexpired)

ground rent 4 x £50 pa = £200 pa

YP @ 11%, say 9 = £1,800

The hearing

The right of the buyer to receive ground rents for the remainder of the terms of the Leases

28. Mr Ray said that the ground rents under the 4 Leases could be taken to have risen in each case to £50 a year by the relevant date, even though the actual date of the increase to that figure was the 25 September 2006, a few days after the relevant date. The total ground rents for present purposes were therefore £200. It was difficult to find anyone to buy ground rents. There would be a disproportionate amount of management work necessary to collect £200 a year. There was in reality only one buyer in this case, namely the Company. At auction, buyers would be prepared to pay for no more than 15 to 18 years of ground rent, and would take no account of the future increases in ground rents specified in the Leases

29. Mr Rashid said that the Company was in the market to buy freeholds, mainly of buildings where the Company already owned a lease of at least one of the flats. He looked at auctions to keep track of prices. On average, the Company was prepared to pay no more than 15 times the current ground rent, and would take no account of future rent increases. In the present case, the Company would take account only of the current rent of £25 a year, and would take no account of the forthcoming increase to £50 a year

30. In answer to questions from the Tribunal, Mr Ray said that the capitalisation rate of 11% adopted in his report was based on his experience of selling ground rents. He had carried out valuations in enfranchisement cases under the 1993 Act, and used a capitalisation rate of 9% in

those cases. The two rates were different because 1993 Act valuations were in an artificial world. However, he acknowledged that his present figure of 15 to 18 years' purchase at £50 a year for each Flat was in fact equivalent to 5.5% to 6.5%, and that the resultant figure was £3,600 (ie 18 years x £50 x 4 Flats), rather than the £1,800 mentioned in his report

The right of the buyer to own the freehold reversion with vacant possession at the end of the Leases

31. Mr Ray said that the remaining Lease terms in this case were over 60 years, and would be regarded in the market as being in perpetuity, so that a buyer in the open market would take no account of the value of the freehold reversion as such

32. In answer to questions from the Tribunal, Mr Ray said initially that he thought that the value of each Flat was about £120,000, based on speaking to agents in Southsea about asking prices of two-bedroomed flats

33. However the Tribunal referred, first, to the fact that the Flats had only one bedroom each, not two, and, secondly to the January 2006 prices of flat 3, 15 Nightingale Road and 21A Nightingale Road mentioned to Mr Rashid by the Tribunal during the inspection

34. In answer to questions from the Tribunal, Mr Rashid said that the Company had bought Flat 1 with vacant possession in 2005 for £105,500

35. Having taken all these points into account, Mr Ray said, on reflection, that he thought that £110,000 was a better figure for the value of each Flat at the relevant date, subject to the existing Leases. If each Flat had had instead a lease for a longer term, say 125 years, at the relevant date, he thought that the value of each Flat would be increased by 2.5% to £112,750

36. In answer to questions from the Tribunal, Mr Ray said that his suggested uplift figure of 2.5% was based on his experience. He did not have any market evidence of relativity to put before the Tribunal. He was not aware of the "graph of graphs" referred to in **Arrowdell**. He had analysed decisions of the Tribunal in Southampton and Chichester, but none were of help in assessing relativity values for the Building

37. On the basis of his uplift figure of 2.5%, Mr Ray thought that the value of the Building as a whole could be put at 4 x £110,000 with the four present Leases, namely £440,000, and at 4 x £112,750 with the four hypothetical leases with 125-year terms, namely £460,000

38. Mr Ray emphasised that in his view a buyer of the Respondent/Landlord's interest would pay nothing for the right of the buyer to the freehold reversion with vacant possession at the end of the Leases. However, if, contrary to his view, the question of a deferment rate were relevant, he would apply a deferment rate of 8% to 9%. He thought the 5% rate arrived at in **Sportelli** was of no application to properties outside the London market

39. Mr Ray said that there was a difference between a converted block, like the Building, and a purpose-built block of flats. The type of buyer who would be interested in buying the freehold would be different too. In the case of a converted block, only someone who already owned a flat in the block would be interested in buying the freehold

Hope value

40. Mr Ray said that a buyer in the open market would take no account of hope value

41. In answer to questions from the Tribunal, Mr Ray said that he would expect to see applications for lease extensions at about the stage in the Lease terms when potential mortgagees were becoming unhappy, namely when there were only about 60 to 70 years remaining. If he were acting for the owner of the freehold he would expect to obtain from each leaseholder about £4,000 for a lease extension, but some freeholders would ask for £8,000 or £9,000. However, any associated hope value would be taken into account by a buyer offering 15 to 18 years purchase of ground rent. The suggestion in **Sportelli** that a buyer of a house would pay 20% of marriage value for hope value did not apply to a buyer of the Building in the open market

Submissions

42. Any attempt to apply 1993 Act enfranchisement valuation methodology to the present case would produce a very high figure which would be totally ridiculous. The appropriate method of valuation was not to apply academic valuation principles which were divorced from reality, but to ascertain the figure which would actually be paid by a buyer in the open market. Mr Ray said that a buyer in the open market would pay no more than £3,600 for the Respondent/Landlord's interest in the Building, and would pay nothing for the right of the buyer to own the freehold reversion with vacant possession at the end of the Leases. Any hope value associated with the possibility of the lessees applying for an extended lease would be included in the £3,600.

The Tribunal's findings

Valuation methodology

43. The Tribunal has taken account of Mr Ray's submission that a buyer in the open market would make a payment based only on the right to receive ground rents. However, the Tribunal finds that a valuation of the Respondent/Landlord's interest in accordance with section 31 of the 1987 Act has to take account not only of the right of the buyer to receive ground rents for the remainder of the terms of the Leases, but also the right of the buyer to own the freehold reversion with vacant possession at the end of the Leases, and any hope value

44. The Tribunal finds that there should be no addition for marriage value, as such, for reasons already given

The right of the buyer to receive ground rents for the remainder of the terms of the Leases

45. The Tribunal finds, contrary to Mr Ray's submissions, that the value of the buyer's right to receive ground rents for the remainder of the terms of the Leases has to take account of the fixed increases in ground rent throughout the terms of the Leases, and that the annual rent figures to take into account in relation to the four Flats are therefore :

£200 (4 x £50) from the relevant date to the 25 September 2031, namely 25 years

£300 (4 x £75) from the 25 September 2031 to the 25 September 2056, namely 25 years

£400 (4 x £100) from the 25 September 2056 to the 25 September 2080, namely 24 years

46. The Tribunal has taken account of Mr Ray's suggestion that the capitalisation rate should be based on 15 to 18 years' purchase, namely 5.5% to 6.5% of the current receivable ground rent. However, based on the Tribunal's collective knowledge and expertise, the Tribunal finds that the appropriate capitalisation rate in this case is 8%

47. The Tribunal accordingly finds that the value at the relevant date of the right of the buyer to receive ground rents for the remainder of the terms of the Leases is £2,693, calculated in accordance with the Tribunal's valuation in the Appendix

The right of the buyer to own the freehold reversion with vacant possession at the end of the Leases

48. The Tribunal finds, contrary to Mr Ray's submissions, that the right of the buyer to own the freehold reversion with vacant possession at the end of the Leases is a valuable right, and is a separate and additional right to the right to receive the ground rents in the meantime

49. The Tribunal finds that the present market value of each Flat is £110,000. In making that finding the Tribunal has taken account of Mr Rashid's evidence that the Company had bought Flat 1 with vacant possession in 2005 for £105,500, and of the January 2006 prices of flat 3, 15 Nightingale Road and 21A Nightingale Road mentioned to Mr Rashid by the Tribunal during the inspection

50. The Tribunal accepts Mr Ray's suggestion that if each Flat were subject to a 125-year lease, then the value of each Flat would be £112,750, and that the current value of the Respondent/Landlord's freehold interest should therefore be £451,000 (4 x £112,750). In making that finding, the Tribunal has taken into account :

- a. the fact, as the Tribunal finds, that the "graph of graphs" referred to in **Arrowdell** would indicate a relativity in values between freehold and leasehold interests in the same building of 6% to 8%, whereas the relativity between £110,000 and £112,750 is 2.5%
- b. the fact that to take the value the Building as £451,000, is to equate the value of the freehold with the combined value of the four leasehold Flats, without any addition of marriage value
- c. however, the fact, as the Tribunal finds that, based on the Tribunal's collective knowledge and expertise, £451,000 is a reasonable valuation at the relevant date of the Respondent/Landlord's interest in the Building with vacant possession

51. In relation to the value of that interest at the date when vacant possession would be available, namely at the end of the current terms of the Leases, 74 years after the relevant date, the Tribunal has taken account of the guidance in **Sportelli** that the deferment rate in the case of a block of flats should be 5% unless there is compelling evidence to the contrary. The Tribunal has taken account of Mr Ray's submission that the deferment rate in **Sportelli** was appropriate only to London properties, and had no application to the Building, and that an appropriate deferment rate for the Building was 8% to 9%. However, the Tribunal finds that there is no evidence before the Tribunal to support Mr Ray's figure, and no evidence at all, let alone compelling evidence, to justify the Tribunal finding a deferment rate higher than the 5% guideline in **Sportelli**

52. The Tribunal accordingly finds that the value at the relevant date of the right of the buyer to own the freehold reversion with vacant possession at the end of the Leases is £12,195, calculated in accordance with the Tribunal's valuation in the Appendix

Hope value

53. The Tribunal has taken account of all the circumstances, including the guidance in **Sportelli**,

and finds that the 5% deferment rate which the Tribunal has applied to the current value of the freehold interest already reflects a range of unknown future factors, including any opportunities for leaseholders to apply for lease extensions, and that there should be no additional sum added to the price to reflect hope value in this case

Total price payable

54. The Tribunal finds that the price payable is £14,890, in accordance with the valuation in the Appendix

Dated the 21 February 2007

A handwritten signature in black ink, appearing to be 'PB' with a flourish at the end.

.....
Peter Boardman
(Chairman)

A Member of the Southern Leasehold Valuation Tribunal
appointed by the Lord Chancellor

RESIDENTIAL PROPERTY TRIBUNAL SERVICE
SOUTHERN RENT ASSESSMENT PANEL
LEASEHOLD VALUATION TRIBUNAL

Case No. CH1/00MR/OCE/2006/0091

11 Nightingale Road, Southsea, Hants, PO5 3JH

Appendix

Tribunal's valuation

			£	£
Present Freehold Interest				
Term 1		200		
YP 25 years @ 8%		10.6748	2,135	
Term 2				
Ground Rent		300		
YP 25 years @ 8%	10.6748			
PV of £1 in 25 years @8%	0.14602			
		1.559	468	
Term 3				
Ground Rent		400		
YP 24 years @ 8%	10.5288			
PV of £1 in 50 years @ 8%	0.02132	0.2245	<u>90</u>	
			2,693	
Reversion to		451000		
PV of £1 in 74 years @ 5%		0.027039		
			<u>12,195</u>	14,888
Premium for the Freehold Interest				£14,890