**LEASEHOLD VALUATION TRIBUNAL FOR EASTERN RENT ASSESSMENT PANEL**

**File Ref No: CAM/22UC/OLR/2005/0002**

**Leasehold Valuation Tribunal: Decision**

**Leasehold Reform, Housing and Urban Development Act 1993 ("the Act")**

**The Tribunal Members were:**

Mrs H Bowers BSc (Econ) MSc MRICS

Mr R Marshall FRICS FAAV

Mr J J Sims LLM

**The Premises:**

Flat 5 Wentworth Court, Alston Road, Barnet, Hertfordshire, EN5 6PA.

**The Applicants:**

Kenneth Edgington and Christine Sorenson

**Respondent:**

Wellcastle Limited

**Date of Inspection and Hearing:** Monday 11th April 2005

**Valuation Date:** 12th August 2004

**Attendance**

Applicants:

Mr I A Rennie BSc, FRICS (Rennie & Partners) (Expert Witness – Valuer)

Mr K Edgington

Respondents:

Miss C Shea (Counsel)

Miss M Morris (Boyes Sutton & Perry)

Mr P Beckett FRICS ( Beckett & Kay) (Expert Witness – Valuer)

## 1. Introduction

1.1 This matter relate to Flat 5, located at Wentworth Court, Alston Road, Barnet (the subject property) and an application pursuant to section 42 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the Act").

1.2 On 12th August 2004, Mrs Edgington served a notice on the landlords, Wellcastle Ltd under section 42 of the Act. The premium proposed in the initial notice was £34,500. A counter-notice under section 45 of the Act was served on 4th October 2004 by Wellcastle Ltd that recognised Mrs Edgington's right to a lease extension and proposing a premium of £57,450. The right to a lease extension was passed to Mrs Edgington's executors, Mr K Edgington and Mrs C Sorenson, at her subsequent death. An application was made on the 6th January 2005 to the Tribunal to determine the terms of acquisition that were in dispute between the parties.

1.3 No evidence or representations were made in respect of other matters raised in the application and in particular the transfer. These matters are therefore adjourned until 24th June 2005. Unless an application is made by either party for a hearing date to dispose of all outstanding issues by that date, the application relating to those issues will stand dismissed.

## 2. The Law

2.1 Chapter II of the Act sets out the provisions for the grant of a new lease and in particular Section 56 provides for a new lease of a flat to be granted for a term expiring 90 years after the expiry of the current lease and at a peppercorn rent. Schedule 13 of the Act sets out the provisions for the calculation of the premium that is payable in respect of the grant of a new lease.

## 3. The Premises

3.1 Shortly prior to the hearing the Tribunal had the opportunity to carry out an inspection of the interior and exterior of the subject property.

3.2 The flat is located in a purpose built block, dating from the 1930's. The block is a two-storey block, of brick and tiled construction. The subject flat is located on the ground floor. The accommodation comprises a living room, a kitchen, two single bedrooms and a bathroom. Some of the rooms are unusual in shape and quite restricting in the space that is provided. The flat is un-modernized and the standard of the kitchen and bathroom fittings are dated. There is no central heating to the flat, although there is one night storage heater and UPVc double glazed window units throughout the property.

3.3 There are small communal gardens to the front and communal grounds to the rear. The flat does not have a garage.

## 4. The Lease

4.1 In the papers submitted to the Tribunal, there was a copy of the original lease. The lease is dated 26$^{th}$ January 1968 and is for a term of 99 years less ten days, from 29$^{th}$ September 1937 at an annual rent of £20.

4.2 Amongst other terms in the lease, the lessee is obliged to repair and maintain the demised premises. The lessee is also liable to pay a proportion of the total cost to the Lessor for the expenses, outgoings and services incurred by the Lessor in fulfilling obligations specified in the lease.

## 5. Agreed Matters

5.1 The valuers provided an agreed statement of facts, in which the property and its location and basic lease details were described. Additionally, the following matters were agreed:

i) The valuation date is 12$^{th}$ August 2004

ii) The value of the flat, freehold and with vacant possession is £160,000.

iii) The value of the extended lease is 99% of that figure, £158,400.

iv) The yield for both capitalisation and deferment is 7.5%.

## 6. Matters in Dispute

6.1 The value of the Flat upon its existing short lease is not agreed and consequentially the premium to be paid has not been agreed.

## 7 Hearing

**Applicant's Case**

7.1 Mr Rennie suggested that the value of the short lease interest in the subject flat could not be valued by using open market comparable evidence as any transactions in the open market would have in mind the provisions of the Act. Additionally, there were no open market transactions in the vicinity that could be used in this case. However, settlements that have been negotiated by professional advisers would have taken account of the "No Act World" scenario and therefore this evidence was more reliable.

7.2 A schedule of five comparables was produced. However, it was clarified that three of the cases in Riseborough Close, N10 were considered as part of one negotiated case. In Riseborough Close the relativity between long lease and short lease values ranged from 59% with 33 years unexpired to 68% for 43 years unexpired. At Stanhope Court in N3, a relativity of 52.5% was agreed for a term of 31 years unexpired. The final case was Paragon House in SE3 and this was a LVT decision that placed a relativity of 77.5% for 35 years unexpired. There were no special features in the negotiation of these settlements. From these comparables, Mr Rennie adopted a relativity of 59% and this produced a short lease value of £94,400 for the subject flat.

7.3 Several of the large London firms have produced tables showing the relativity between short and long lease interests. However, Mr Rennie felt that it was better to rely upon his own experience of settlements, than to extrapolate data from another source.

7.4 Using a Discounted Cash Flow (DCF) calculation to value the short lease interest had some merit, but in the opinion of Mr Rennie using comparables to derive the short lease value of the flat was the best methodology to be applied. By using a DCF there must be many assumptions made and some factors will be very personal to the investors own requirements. However, Mr Rennie produced a DCF calculation, which placed a value of £95,000 on the short lease interest. To carry out the DCF calculation the following assumptions were made:

i) Gross annual rent of £9,000 per annum.

ii) Deductions of 27.5% for repairs, insurance, voids etc.

iii) Rental growth of 2% per annum, to be projected to the end of every five year period.

iv) A yield of 7.5% was adopted, this yield was agreed between the Valuers.

7.5 The gross annual rent of £9,000 is based upon two individuals sharing the flat and rental levels in areas such as Barnet, Hatfield and Muswell Hill. No actual comparable evidence was produced but Mr Rennie had spoken to local agents who knew the block and were familiar with what rental levels could be achieved. The rental value was based upon the current condition of the property. He considered that it was better to rely on market evidence of rental values than to analyse capital values using a 5% yield.

7.6 The rental deductions of 27.5% are based upon Mr Rennie's experience. Mr Rennie was of the opinion that some aspects of the routine repairs proposed in Mr Beckett's schedule were too high. The level of letting fees suggested by Mr Beckett could be reduced significantly. As the unusual accommodation provided in the flat would lend itself to sharers, there would be minimal void periods. There are some risk elements associated with letting of residential property are reflected in the yield of 7.5%.

7.7 There would be rental growth over the remaining 32 years, most tenants are willing to accept small RPI increases over time and therefore it would be reasonable to assume rental growth in the DCF calculation. Rental growth in Muswell Hill was in the region of 2-3% per annum. In Mr Rennie's opinion the Savills tables that were produced by the Respondents showing rental growth in central London areas, were not representative of what was occurring in Barnet and the surrounding area. Mr Rennie had no evidence to support this contention, it was just a matter of his experience.

7.8 From the conventional approach a value for the short term lease of £94,400 is produced or from the DCF a figure of £95,000 is obtained. By adopting a figure of £94,400 into the calculation of the premium payable for an extension of the lease a figure of £40,000 is achieved. Mr Rennie's valuation is shown in Appendix 1.

**Respondent's Case**

7.9 In the opinion of Mr Beckett, any transaction for a short lease term since 1993 would be contaminated by the influence of the Act and therefore any open market comparable data must be treated with caution. In general there are no transactions of short leases that are uncontaminated by the Act.The comparables produced by Mr Rennie, depended upon earlier transactions and that at each occasion there was a "piggy back" effect of cases settled upon old evidence and therefore the settlements were contaminated. The full circumstances of each case was not explained in any detail and in a complex valuation there may be elements that had been conceded on one part in order to gain an advantage on another aspect.

7.10 One of the major factors affecting the value to be placed on a property was its mortgageability. Due to the short nature of the leasehold interest in the subject property, it would be very difficult to obtain a mortgage. A partner in Mr Beckett's firm has carried out research in order to ascertain what unexpired length of term would be necessary to satisfy a lender's requirements. The results indicate that nearly all lenders approached, would not lend on an unexpired term of 32 years. The lenders approached would require a period from 25 up to 60 years beyond the term of a mortgage. The right to a lease extension appeared to have no impact upon the attitude of the lender's approached. Therefore there is a very limited market for owner occupiers of the subject property and it would be necessary to look at the property as an investment opportunity. The view was expressed that there would always be circumstances where the need for a mortgage was not necessary and that in central London there is a more specialist market that would attract purchasers to consider short term leases.

7.11 Given that there would be doubts whether the property could be purchased in the open market on a conventional basis, then it was necessary to consider an alternative valuation approach. In a situation such as this it is more appropriate to use a DCF calculation to obtain the short lease value. In doing so Mr Beckett made the following assumptions:

i) Gross rental value £8,000 per annum, based on 5% of the freehold value.

ii) Deductions of 40% to reflect repairs, management, service charges, insurance, voids, bad debts, letting fees, replacement of internal fixtures, etc.

iii) A yield of 7.5%, a sinking fund of 2.5% and a tax rate of 25% was used.

7.12 The yield of 7.5% that is adopted is a gross yield and is a figure that has been agreed between the Valuers in the calculation of the premium. The 5% yield used to derive the rental value is a yield that shows the relationship between rental and capital values. After the deductions this yield would be equivalent to 3%. Such a low yield is acceptable as this would reflect some potential for rental growth, but the main reason for such a low yield is the anticipated capital growth in the Buy to Let market. One of the bedrooms in the subject flat is small and that would make it difficult for sharers. If a sharer would normally pay £100 per week, then this flat would go for £160 per week, due to the smaller room. The flat is below current letting standards and would need to be refurbished prior to being let.

7.13 The data produced by Savills suggests that there is a 40% difference between gross and net yields on flats and that there is a 47% deduction on all properties. This data supports Mr Beckett's view that deductions to achieve a net rent should be 40%. A schedule of all the deductions was produced by Mr Beckett, that showed the items that in his opinion would be the deductions that would be expected to be made to arrive at a net rent. These deductions included routine maintenance items, letting fees and bad debts, decorations and items of depreciation.

7.14 Given the assumptions made by Mr Beckett this provides a valuation of the short lease interest at £57,673. This value is then used to calculate the premium payable for the lease extension, namely £58,000. Mr Beckett's valuation is reproduced in Appendix 2.

## 8. Determination

8.1 The first issue to address is the valuation approach to be taken. We were not presented with any open market transactions of short term lease, although we acknowledge the point that this evidence would have been contaminated by the presence of the Act. The evidence produced by Mr Rennie is fairly limited as there were only two sets of negotiated settlements that had been relied upon. We were persuaded that the use of the negotiated settlements produced by Mr Rennie was of limited use as all the features of the valuation were not presented to us. Also and there is a degree of reliance on old evidence that is not explained and there may be some degree of "piggy backing" on previous cases. The research that was undertaken to show the limitations of obtaining a mortgage on a short lease term of the subject property was convincing and we accept that with a lease term of this length there would be a fairly limited market. Therefore looking at investors as a potential purchaser and that a DCF is a valid valuation approach we have determined that this is the method that should be adopted in this case to find the short lease value of the lease.

8.2 When determining the rent that should be used in the DCF, the most favourable approach would be to base this value upon the evidence of local market transactions. Mr Rennie showed a preference for this approach and suggested that the rental value would be in the region of £9,000 per annum based upon rental levels of £175 per week. Mention was made of discussion with local agents, but no actual comparables were offered to the Tribunal. Mr Beckett preferred the method of using a 5% yield on the capital value to calculate a rent of £8,000 per annum. We considered that the use of a yield to de-capitalise the rent was fraught with problems. The yield rates indicated in the Savills report were far too remote from the actual situation in Barnet and that by analysing capital values in this way could easily lead to a very hypothetical situation. This over analysis could become a mathematical exercise in its own right and become far too remote from what was actually happening in the market. As an expert tribunal we have knowledge of market rents for this type of property. In our opinion and given the size, layout and physical condition of the property the rental value of the flat would be in the region of £150 to £160 per week and this equates to £8,000 per annum.

8.3 The next factor that needs to be considered is the level of deductions that is necessary to take from the gross rent to determine the net rent. Mr Rennie suggested that 27.5% should be deducted from the rent and Mr Beckett proposed a 40% deduction was appropriate. The deductions schedule that Mr Beckett provided was very useful and Mr Rennie was in agreement with quite a number of the items. However, we agreed with Mr Rennie that some aspects of routine maintenance suggested on the schedule were too high and that the voids and bad debts, whilst considered by an investor, were a little too pessimistic. However, a prudent investor would take many of these factors into account and have a rigorous appraisal. In our opinion the deductions from the gross rent should be 35%.

8.4 The final aspect to be considered in the DCF was the question of rental growth. We acknowledge the Savills data that was produced by Mr Beckett and yet again must stress that reliance on actual information from the local market is more useful than the extrapolation of information gathered from a wider area and without a full examination of the factors involved. The 7.5% yield that was adopted by both Valuers would in our opinion reflect that there is some rental growth anticipated and that accordingly there is a risk factor involved in the question of whether rental growth is achieved. If the rent was to be fixed for the whole period with no growth anticipated then in our opinion there would be a lower yield used in the DCF. Accordingly we have adopted the rental growth figures proposed by Mr Rennie.

8.5 By using a gross rental value of £8,000 per annum, with deductions of 35% and adopting rental growth throughout the remaining period then the DCF will produce a value of £75,913 for the short term lease. This calculation is shown in Appendix 3. Placing this figure into the calculation for the premium for the lease extension will produce a value of £49,200 and this is shown in the valuation shown in Appendix 4.

## 9. Decision

9.1 The value of the short term lease is £75,913.

9.2 Accordingly, the price to be paid by the Applicants for a lease extension of the subject premises is £49,200.

Chairman
Helen C Bowers

Date 20/5/05.

**Appendix 1**

**Applicant's Valuation**

| | | | |
|---|---|---|---|
| **a) Diminution in the value of the landlord's interest** | | | |
| i) Ground Rent now | 20 | | |
| YP 32.10 years @ 7.50% | 12.0250 | 241 | |
| ii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 32.10 years @ 7.50% | 0.0981 | 15,696 | |
| **Landlord' interest before lease extension** | | 15,937 | |
| iii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 122.10 years @ 7.50% | 0.0001 | | |
| **Landlord's interest after lease extension** | | 16 | |
| **Diminution in the value of the landlord's interest** | | | **15,921** |
| **b) Landlord's share of marriage value** | | | |
| *Interests after marriage* | | | |
| Value on extended lease | 158,400 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of lessee's interest | | 158,400 | |
| Landlord's interest after lease extension | | 16 | |
| Value of combined interests after lease extension | | 158,416 | |
| *Interests before marriage* | | | |
| Value of lessee's current interest | 94,400 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of the lessee's interest | 94,400 | | |
| Landlord's interest before lease extension | 15,937 | | |
| Value of combined interests before lease extension | | 110,337 | |
| **Marriage Value, therefore** | | 48,079 | |
| Landlord's Share | 50% | | |
| **Landlord's Share of marriage value** | | | **24,040** |
| **Price payable under the Act** | | | **39,976** |
| **But say** | | | **£40,000** |

Appendix 2

**Respondent's Valuation**

**b) Diminution in the value of the landlord's interest**

| | | | |
|---|---|---|---|
| i) Ground Rent now | 20 | | |
| YP 32.10 years @ 7.50% | 12.0250 | 241 | |
| ii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 32.10 years @ 7.50% | 0.0981 | 15,696 | |
| **Landlord' interest before lease extension** | | 15,937 | |
| iii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 122.10 years @ 7.50% | 0.0001 | | |
| **Landlord's interest after lease extension** | | 16 | |
| **Diminution in the value of the landlord's interest** | | | **15,921** |

**b) Landlord's share of marriage value**

| | | | |
|---|---|---|---|
| *Interests after marriage* | | | |
| Value on extended lease | 158,400 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of lessee's interest | | 158,400 | |
| Landlord's interest after lease extension | | 16 | |
| Value of combined interests after lease extension | | 158,416 | |
| *Interests before marriage* | | | |
| Value of lessee's current interest | 57,673 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of the lessee's interest | 57,673 | | |
| Landlord's interest before lease extension | 15,937 | | |
| Value of combined interests before lease extension | | 73,610 | |
| | | 84,806 | |
| **Marriage Value, therefore** | | | |
| Landlord's Share | 50% | | |
| **Landlord's Share of marriage value** | | | **42,403** |
| **Price payable under the Act** | | | **58,324** |
| **But say** | | | **£58,000** |

Discounted Cash Flow

**Appendix 3**

| Year | ERV | Net Rent | Deferred yrs | Present Value Factor | Present Value |
|---|---|---|---|---|---|
| 2004 | 2,667 | 1,733 | 0 | 1 | 1733 |
| 2005 | 8,000 | 5,200 | 1 | 0.930233 | 4837.212 |
| 2006 | 8,000 | 5,200 | 2 | 0.86533 | 4499.716 |
| 2007 | 8,000 | 5,200 | 3 | 0.804961 | 4185.797 |
| 2008 | 8,000 | 5,200 | 4 | 0.748801 | 3893.765 |
| 2009 | 8,000 | 5,200 | 5 | 0.696559 | 3622.107 |
| 2010 | 8,832 | 5,741 | 6 | 0.647962 | 3719.95 |
| 2011 | 8,832 | 5,741 | 7 | 0.602755 | 3460.416 |
| 2012 | 8,832 | 5,741 | 8 | 0.560702 | 3218.99 |
| 2013 | 8,832 | 5,741 | 9 | 0.521583 | 2994.408 |
| 2014 | 8,832 | 5,741 | 10 | 0.485194 | 2785.499 |
| 2015 | 9,752 | 6,339 | 11 | 0.451343 | 2861.063 |
| 2016 | 9,752 | 6,339 | 12 | 0.419854 | 2661.455 |
| 2017 | 9,752 | 6,339 | 13 | 0.390562 | 2475.773 |
| 2018 | 9,752 | 6,339 | 14 | 0.363313 | 2303.041 |
| 2019 | 9,752 | 6,339 | 15 | 0.337966 | 2142.366 |
| 2020 | 10,766 | 6,998 | 16 | 0.314387 | 2200.08 |
| 2021 | 10,766 | 6,998 | 17 | 0.292453 | 2046.586 |
| 2022 | 10,766 | 6,998 | 18 | 0.272049 | 1903.799 |
| 2023 | 10,766 | 6,998 | 19 | 0.253069 | 1770.977 |
| 2024 | 10,766 | 6,998 | 20 | 0.235413 | 1647.42 |
| 2025 | 11,886 | 7,726 | 21 | 0.218989 | 1691.909 |
| 2026 | 11,886 | 7,726 | 22 | 0.203711 | 1573.871 |
| 2027 | 11,886 | 7,726 | 23 | 0.189498 | 1464.062 |
| 2028 | 11,886 | 7,726 | 24 | 0.176277 | 1361.916 |
| 2029 | 11,886 | 7,726 | 25 | 0.163979 | 1266.902 |
| 2030 | 13,125 | 8,531 | 26 | 0.152539 | 1301.31 |
| 2031 | 13,125 | 8,531 | 27 | 0.141896 | 1210.515 |
| 2032 | 13,125 | 8,531 | 28 | 0.131997 | 1126.066 |
| 2033 | 13,125 | 8,531 | 29 | 0.122788 | 1047.504 |
| 2034 | 13,125 | 8,531 | 30 | 0.114221 | 974.4194 |
| 2035 | 14,490 | 9,418 | 31 | 0.106252 | 1000.681 |
| 2036 | 14,490 | 9,418 | 32 | 0.098839 | 930.8657 |
| | | | | | **75913.44** |

Say £75,913

Appendix 4

**Leasehold Valuation Tribunal's Valuation**

| | | | |
|---|---|---|---|
| **c) Diminution in the value of the landlord's interest** | | | |
| i) Ground Rent now | 20 | | |
| YP 32.10 years @ 7.50% | 12.0250 | 241 | |
| ii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 32.10 years @ 7.50% | 0.0981 | 15,696 | |
| **Landlord' interest before lease extension** | | 15,937 | |
| iii) Reversion to freehold value | 160,000 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved freehold value | 160,000 | | |
| Deferred 122.10 years @ 7.50% | 0.0001 | | |
| **Landlord's interest after lease extension** | | 16 | |
| **Diminution in the value of the landlord's interest** | | | **15,921** |
| **b) Landlord's share of marriage value** | | | |
| *Interests after marriage* | | | |
| Value on extended lease | 158,400 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of lessee's interest | | 158,400 | |
| Landlord's interest after lease extension | | 16 | |
| Value of combined interests after lease extension | | 158,416 | |
| *Interests before marriage* | | | |
| Value of lessee's current interest | 75,913 | | |
| Less value of lessee's improvements | 0 | | |
| Unimproved value of the lessee's interest | 75,913 | | |
| Landlord's interest before lease extension | 15,937 | | |
| Value of combined interests before lease extension | | 91,850 | |
| **Marriage Value, therefore** | | 66,566 | |
| Landlord's Share | 50% | | |
| **Landlord's Share of marriage value** | | | **33,283** |
| **Price payable under the Act** | | | **49,204** |
| **But say** | | | **£49,200** |