Y Tribiwnlys Eiddo Preswyl

Residential Property Tribunal Service (Wales)

Leasehold Valuation Tribunal (Wales)

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DECISION AND REASONS OF LEASEHOLD VALUATION TRIBUNAL (WALES)
Leasehold Reform Act 1967 s.27

Premises:	23 Mervyn Way, Pencoed, Bridgend, CF35 6JH ("the Property")
LVT ref:	LVT0013/07/15 – Mervyn Way
Order:	14 December 2015
Applicant:	Mrs Sheila Margaret Davies
Tribunal:	Mr R S Taylor – Legal Chairman Mr R Baynham FRICS

ORDER

1. The price to be paid into court by the Applicant for the freehold interest of the Property is £2,310.

Dated 14 December 2015

Lawyer Chairman

Background.

1. This case concerns the valuation of the appropriate price to be paid by the Applicant for the freehold reversion of the Property.
2. The Applicant made an application via Part 8 of the Civil Procedure Rules to Bridgend County Court on the 24 April 2015, pursuant to s.27 of the Leasehold Reform Act 1967 (as amended) ("the Act") for the purchase of the freehold reversion of the Property.
3. The matter came before District Judge Scannell sitting in the Bridgend County Court on the 1 July 2015 when she ordered that the application be transferred to the Leasehold Valuation Tribunal to determine the sum to be paid for the freehold interest in the Property. Thereafter the matter was listed for directions in the Tribunal on the 22 July 2015, when standard directions were given for a hearing of this matter.
4. The lease of the property was granted for a term of 99 years from the 25 December 1975. The lease states that the annual ground rent is £22. There were 59 years and 8 months unexpired at the valuation date.
5. The Tribunal must determine the purchase price on the relevant day. The relevant day in this case is the date of application to court, namely the 24 April 2015 ("the valuation date.")
6. The Act enables tenants of long leases let at low rents to enfranchise their properties – in other words to acquire the freehold on terms as set out in the Act. s.27 of the Act which provides for an application to the court and sets out the procedure to be followed where the landlord cannot be found.
7. One part of this procedure requires a Leasehold Valuation Tribunal to determine the purchase price, in accordance with the appropriate valuation methodology as set out in the Act. The valuation methods are set out in s.9 of the Act, which has been amended several times and now provides for valuation upon a number of different bases, depending upon which category the property and the lease fall into.
8. In the case of a property with a low ratable value outside of London, that is less than £500 on the 31 March 1990, the valuation methodology is the s.9(1) valuation. In this case the ratable value of the Property on the 31 March 1990 will be less than that figure, bringing the valuation head under s.9(1) of the Act.
9. Section 9(1) of the Act states that our role is to determine "the amount which at the relevant time the house and premises, if sold in the open market by a willing seller (with the tenant and members of his family…not buying or seeking to buy) might be

expected to realise…" We are required to make certain assumptions one of which is that the Property is being sold freehold but subject to the lease which, if it has not already been extended, has been extended by 50 years. In other words the assumed term expires 50 years after the contractual term date. Here, the contractual term ends in 2074 so that the assumed date when the lease will expire is in December 2124.

10. In the past, it has been accepted that, what is sometimes called, the "two stage" approach would generally be used where there were, say, over 50 years to run on the lease so that the deemed expiry date was over 100 years into the future. This involves ascertaining a modern ground rent for the Property (or, as it is more properly called, a section 15 ground rent), recapitalising that section 15 ground rent in perpetuity, and deferring that value to the end of the current term. Nonetheless, it was always considered more likely that the market would adopt the "three stage" approach or, as it is often called, the *Haresign* approach (named after the Lands Tribunal's decision in *Haresign v St John the Baptist's College Oxford* (1980) 255 EG 711), where that approach produced a value significantly higher than that achieved by the two stage approach. In the "three stage" approach, the section 15 ground rent is capitalised only for 50 years, deferring the result to the end of the current term. The added third stage is to calculate the standing house value of the Property and defer that value 50 years beyond the end of the current term.

11. Mr. John Caines, the Applicant's valuer, has employed the "three stage" approach in order to calculate his valuation, in accordance with the Upper Tribunal in *Clarise Properties Limited* [2012] UKUT 4(LC)(*Clarise*). *Clarise* advocated the use of the "three stage" approach "where the reversion does have a significant value. In future, therefore , we consider that the appropriate approach will be to capitalise the section 15 ground rent to the end of the 50 year extension and to assess the value (if any) of the ultimate reversion". There is no suggestion that the house will not still be standing at that time, provided it is properly maintained. We accept that there is no guarantee that in the future it will be maintained as it has been to date, but in the absence of any evidence to suggest otherwise, we conclude that it is appropriate to adopt the three stage approach as used in *Clarise* to determine the value of the freehold reversion.

Inspection.

12. The Tribunal inspected the property on 14 December 2015. The property compromises a middle link house, constructed in about 1976. It is conventionally built with cavity brick exterior walls with a tiled roof. The property has the benefit of doubled glazed UPVC windows and double French doors leading to the rear garden. It has the benefit of full gas central heating.

13. The houses on this development do not stand side by side, but are staggered so that one half of the property is overlapped by half of one adjoining property and, in turn, overlaps half of the other adjoining property.

14. The Property is located in a quiet cul-de-sac, set back from the road and approached through a gap in a communal wall and by means of a footpath. At the rear of the Property is a wooded area. There is no rear lane access. Close by is the communal parking area. The car parking spaces are not designated. There is no parking facility either at the front or rear of the Property.

15. The accommodation comprises a small entrance hall, a living room with a staircase leading to the first floor and a kitchen with adequate base and wall units. On the first floor there is a landing and two double bedrooms, together with a bathroom which comprises a bath with shower over, wash hand basin and toilet. The front garden consists of a paved path and lawn whereas the rear the garden, which is of reasonable size, comprises a paved and gravel patio, lawn and a nicely appointed wooden garden shed.

Determination

16. Whilst we accept the overall methodology of Mr. Caines, we have differed in some of the particular conclusions he has arrived at. In summary,

    a. We have taken the more precise approach to looking at the precise length of the unexpired term, which is 59.66, rather than Mr. Caines' 59 years.

    b. We have differed in our view as to the entirety value of the property and the site percentage.

    c. We have further differed on the percentages used for the capitalisation of the ground rent and the calculation of the figure to defer the modern ground rent to present value.

Capitalisation rate for unexpired term

17. The remaining unexpired term at the valuation date was 59.66 years. The ground rent in the lease is for £22 per annum, which Mr. Caines has capitalised at 6.5%. In our view a figure of 6.5% is appropriate and in line with other decisions of this Tribunal.

18. This produces a figure for the valuation of the term of £330.56.

Entirety Value

19. In the absence of any comparable evidence of plots or development land nearby, Mr. Caines has approached this exercise by taking the entirety value of the property and then taking a percentage to arrive at the plot value. In adopting this valuation method the Tribunal must consider the property to be in a modernised state, with covenants fully complied with and to be fully developing the value of the site.

20. Mr. Caines supplied three comparables:-

    a. 22 Mervyn Way, where we are informed that a sale price of £94,000 was agreed in February 2014. However, the vendor later withdrew from the sale. A differently constituted Leasehold Valuation Tribunal considered a similar application to purchase the freehold, which was determined in January 2015. This must mean that the sale which was agreed was upon a leasehold basis, something which Mr. Caines appears to be unaware of. The tribunal has previously determined 22 Mervyn Way as having an entirety value of £102,000.

    b. 17 and 20 Heol Maes y Haf, Pencoed, CF35 5PJ where the sales were agreed at £104,000 in July 2015 and £107,500 in June 2015 respectively. These are two bedroom properties situated some distance from the Property on an attractive, modern, well laid out estate, close to the M4. Both have front and rear gardens and off street parking.

21. When viewing the exterior of Mr. Caines' comparables at 17 and 20 Heol Maes Y Haf, we also noted that his firm has a property for sale at £112,000 on the estate, the configuration of the property being as described above.

22. We find that Mr. Caines' suggested entirety value of £95,000 to be too low. This, no doubt, is heavily influenced by the misleading comparison of the aborted leasehold sale at 22 Mervyn Way. Notwithstanding the different valuation dates for 22 and 23, they are relatively close to each other (22 Mervyn Way, valuation date was January 2015). We can see no reason why the entirety value should not be £102,000.

Site value.

23. Mr. Caines' contended for a site value of 35% would be appropriate.

24. Notwithstanding the pleasant gardens to front and rear, the site is not large enough to justify such a high percentage in our view. 30% is more in keeping with a property of this size and previous decisions of this tribunal.

25. Although the configuration of the plot might present some difficulty in notional construction, these difficulties will be reflected in the ultimate value of the completed house. To reduce the value of the plot as a percentage of the value of the Property would in this case represent a double discount. We determine the site value percentage to be 30%. The plot value is therefore £30,600.

Decapitalisation

26. Mr. Caines has contended for a rate of 5.5% for decapitalisaion, the process to ascertain the section 15 rent. We consider that this is too high. The Applicant elected for a paper determination of this matter, so we have not had the benefit of being able to question Mr. Caines as to why he contends for 5.5%. In the absence of such assistance we must do the best we can on the evidence before us and bearing in mind that a differently constituted tribunal has recently determined the same issues in respect of 22 Mervyn Way.

27. We adopt the tribunal's helpful observations in the matter of 22 Mervyn Way on this issue, namely,

> "[17] Returns in the market are currently at a low level, although they may not always remain this low. They are affected by economic conditions and landlords are still accepting lower rents in order to keep premises tenanted. The section 15 ground rent would be fixed for 25 years, which is why the rate is bound to be higher than "high street" rates advertised by banks and building societies. Using our own knowledge and experience, we therefore consider that the appropriate decapitalisation rate is 5%, namely £1,530 pa."
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> [18] We appreciate that in *Clarise* the Upper Tribunal endorsed a rate of 5½%. This was the rate which the parties had agreed should apply to the deferment rate before the Leasehold Valuation Tribunal. The Upper Tribunal appears to be suggesting that the deferment rate determines all three rates - decapitalisation, recapitalisation as well as deferment. In our view, the process of decapitalisation – which can be independent

> of the acquisition of a freehold reversion – is fundamentally different from the deferment exercise. The former is establishing a return on an investment, the latter the price someone would be prepared to pay today for an asset which will not be in the buyer's possession for many years. This does not seem to have been considered by the Upper Tribunal in *Clarise*. We conclude that notwithstanding the guidance in *Clarise*, and in line with other decisions of this Tribunal, the appropriate rate for decapitalisation is 5%."

28. We determine that the Modern Ground Rent figure at 5% results in a figure of £1,530.

Recapitalisation

29. In order to avoid what is sometimes referred to as an adverse differential, the same rate as was used for decapitalisation, i.e. to ascertain the section 15 ground rent, must be used to recapitalise the modern ground rent before deferring it. (See Lord Denning MR in *Official Custodian for Charities and Others v Goldridge* (1973 26 P & CR 191): "They should adopt the same percentage for re-capitalisation as for decapitalisation. This is a better way of finding 'fair terms'"). Using a different rate for recapitalisation produces an unfair advantage to one side or the other. We therefore adopt the same rate for recapitalisation as decapitalisation, namely 5%.

Deferment

30. Mr. Caines has contended for a deferment rate of 5.5%, without articulating a particular reason for alighting on this figure. We assume that this is based upon the factual determinations in the case *Clarise* itself

31. In *Clarise* the Upper Tribunal used the *Sportelli* deferment rate of 4¾% as its starting point. However, it accepted the argument that the prospects for capital growth were lower in the West Midlands than in Prime Central London (PCL) and increased the rate by ½% to 5¼%. It then added a further ¼% to the deferment rate because the reversion was to a house and to allow for the possibility of greater deterioration relative to value for properties outside PCL. It considered that the cost of repairing a house outside PCL was relative to value more expensive than the cost of repairing a house within PCL. In *Sinclair Gardens Investments (Kensington) Ltd* [2014] UKUT 0079, the Upper Tribunal (Martin Rodger QC and A J Trott FRICS) emphasised the importance of relating the additional ¼% to the "characteristics of the property in question". In this case, the unusual configuration together with the lack of any competent regime for managing the common areas, are in our view likely to cause an

investor to perceive a greater risk of deterioration and obsolescence than already accommodated in the *Sportelli* risk premium or reflected in the freehold vacant possession value.

32. Whilst we consider it correct to add the ¼% to the basic *Sportelli* rate of 4¾% to account for the deterioration factor, in the absence of evidence relating to the growth factor, we are unable to justify adding a further ½%. Our determination is 5%. This has the effect of valuing what is sometimes referred to as the first reversion at £1520.30.

Standing house reversion

33. The final stage in the valuation process is to determine the value of the Property and defer that figure for the period of the contractual term plus the deemed 50 year extension as prescribed by the Act. For this we use the value of the Property in its existing form as at the valuation date. The entirety value is based upon the assumption that the Property is in good repair and condition and fully develops the site. In our view, it is in such condition now and was no doubt in April 2015. We do not consider that there would have been any significant difference between the entirety value and the standing house value. We therefore determine that the standing house value is £102,000.

Schedule 10 of the Local Government Act 1989

34. In *Clarise*, the Upper Tribunal dealt with the assumption that Schedule 10 of the Local Government and Housing Act 1989 (the 1989 Act) might apply to the tenancy created by the lease. Under the 1989 Act, the original tenancy automatically continues until notice is served under paragraph 4 of Schedule 10. The lessee is then entitled to an assured tenancy under the Housing Act 1988 at a market rent. The reversioner will therefore not be certain that it will obtain possession. The Upper Tribunal held that that uncertainty would have a depressing effect upon the value of that reversion. In Clarise, it reduced the standing house value (not the same as the entirety value used for ascertaining the plot value) by 20%.

35. The Upper Tribunal commented that whilst "the purchaser of the freehold reversion would have no means of knowing whether vacant possession would be gained at the end of the 50 year lease extension"…"the fact that there can be no certainty of obtaining vacant possession would have a significant depressing effect on value…" Without the benefit of comparable evidence, the Upper Tribunal deducted 20% from the "full standing house value" of the Property.

36. This issue had been considered previously by the *Lands Tribunal in Vignaud v Keepers and Governors of John Lyon's Free Grammar School* (LRA/9 & 11/1994) (*Vignaud*) and by the Upper Tribunal in *Sillvote Ltd v Liverpool City Council* [2010] UKUT 192 (LC) (*Sillvote*). In the former case, HH Judge Rich accepted a deduction of 10% to reflect "the remote risk that [the leaseholder] or some assignee in the last ten months of the term might" exercise the tenant's rights under Schedule 10 and remain in possession even though the Judge was "virtually certain" that the leaseholder would not exercise those rights. In his decision, HH Judge Rich stated that "the proper deduction for this right must be a matter of evidence or agreement". In Sillvote, where there were 11 years remaining on the lease, Mr. P R Francis FRICS stated that the question was "whether, as a matter of evidence, there is a likelihood that the lessee will exercise that right". He held that there was no evidence and consequently made no deduction. Following that decision, in *Cardiff County Council v The Estate of Alice Zelia David* (3 Ovington Terrace, Cardiff)(reference QA 976565) this Tribunal also held that it had no evidence upon which to base a deduction from the house value to take account of the lessee's Schedule 10 rights. In *Clarise*, the Surveyor for the Appellant had suggested a nominal deduction to take account of the fact that these rights would only be exercisable at the end of the statutory 50 year lease extension – in *Clarise*, in 78½ years' time. However, the Upper Tribunal made its 20% deduction on the assumption that the deduction had to be significant.

37. In this case, the extended lease term ends 109.66 years after the valuation date, a longer period than that in *Clarise* and substantially longer than *Vignaud* and *Sillvote*. We acknowledge the Upper Tribunal's guidance and therefore we conclude that a significant deduction needs to be made from the standing house value in order to take account of the lessee's Schedule 10 rights. The amount of such deduction is preferably to be based upon evidence, but, as with *Clarise*, we have none provided on behalf of the Applicants. We must therefore rely upon our knowledge and experience. The value of the Schedule 10 rights is essentially a question of judgment. We do not consider that the market would factor in a deduction as high as 20% to take account of the possibility that a lessee might retain possession in 109.66 years' time with the benefit of an assured tenancy. In our judgment, we consider the appropriate deduction is 5% - significant enough to take account of the risk of those rights being exercised, but not such as to over compensate bearing in mind that these rights are only exercisable in 109.66 years' time and indeed may not be exercised at all. This produces an adjusted standing house value of £96,900.

38. Applying the same deferral rate of 5% as above to the standing house value, the second reversion is valued at £459.89 to which we add the capitalised current ground rent of £330.56 and the value of the first reversion of £1520.30 making a total of £2310.75, say £2,310. We have set out the valuation below.

39. Section 27(5)(b) of the Leasehold Reform Act 1967, substituted by section 149 of the Commonhold and Leasehold Reform Act 2002, requires the leaseholder to pay "the amount or estimated amount ....of any pecuniary rent payable for the house ...which remains unpaid". The amount so payable can only be the amount for which the freeholder can enforce payment, namely 6 years. However, we have only been asked to determine the value of the freehold reversion. We therefore refer back to the County Court the question of any ground rent arrears.

Decision

40. Applying the findings we have made above, we calculate the value of the freehold of the property as follows:-

Stage 1.

Ground rent	£22.00	
YP 59.66 years at 6.5%	15.02535	
		£330.56

Stage 2.

Entirety Value	£102,000		
Plot Value @30%	£30,600		
Modern Ground rent @5%		£1,530	
YP 50 years @5%	18.2559		
PV of £1 in 59.66 years @5%	0.05443		
		0.99366	
			£1,520.30

Stage 3.

Standing house value	£102,000	
Less Schedule 10 @5%	£5,100	
Adjusted value		£96,900

PV in 109.66 years @5%	0.004746	
		£459.89
Total		**£2,310.75**
Say		**£2,310**

Dated 14 December 2015

Lawyer Chairman