UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2017] UKUT 178 (LC)
UTLC Case Number: LRA/102/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – Premium – whether FTT made arithmetical mistake in calculating value of existing lease – whether allowance for the benefit of the Act should be made – deferment rate adjustments – whether appropriate to allow for Schedule 10 rights under Local Government and Housing Act 1989 – whether long leasehold value should be increased to give FHVP value – appeal allowed in part – premium assessed at £8,300

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

BETWEEN:

CONTACTREAL LIMITED **Appellant**

and

MS HANNAH M SMITH **Respondent**

Re: Flat 23,
Hitchman Court
Hitchman Road
Leamington Spa
CV31 3QP

Determination on Written Representations

The following cases are referred to in this decision:

Cadogan (Earl) v *Cadogan Square Limited* [2011] UKUT 154 (LC)
Sarum Properties Ltd v Cooley Stuart Webb & Others [2009] UKUT 188 (LC)
Re Clarise Properties Limited's Appeal [2012] UKUT 4 (LC)
Re Midland Freeholds Limited's Appeal [2014] UKUT 304 (LC)
Nailrile Limited v Earl Cadogan [2009] RVR 95
The Trustees of the Sloane Stanley Estate v Mundy [2016] UKUT 223 (LC)
Denholm v Stobbs [2016] UKUT 288 (LC)
Re Coolrace Limited's Appeal [2012] UKUT 69 (LC)
Zuckerman v Trustees of the Calthorpe Estate [2009] UKUT 235 (LC)
Re Sinclair Gardens Investments (Kensington) Limited's Appeal [2014] UKUT 79 (LC); [2015] EWCA Civ 1247
Earl Cadogan and Cadogan Estates Limited v Sportelli and Others [2007] I EGLR 153 (LC); [2008] 1 WLR 2142 (CA)
City & Country Properties Limited v Yeats [2012] UKUT 227 (LC)
Vignaud v Keepers and Governors of John Lyons Free Grammar School (1996) 71 P&CR 456
Earl Cadogan v Erkman [2011] UKUT 90 (LC)
Mallory v Orchidbase Limited [2016] UKUT 468 (LC)

DECISION

Introduction

1. This is an appeal by Contactreal Limited against a decision of the First-tier Tribunal (Property Chamber) ("FTT") dated 23 June 2016 determining a premium of £6,750 to be paid for a new lease under the Leasehold Reform, Housing and Urban Development Act 1993 of Flat 23, Hitchman Court, Hitchman Road, Leamington Spa, CV31 3QP.

2. The qualifying tenant and respondent to the appeal is Ms Hannah Smith.

3. The Tribunal gave permission to appeal on 4 November 2016 and directed that the appeal be dealt with as a review of the FTT's decision conducted under the Tribunal's written representations procedure.

4. The appellant relies upon its grounds of appeal and the expert evidence given to the FTT on its behalf by Mr Kieron McKeown MRICS, principal of McKeown & Co LLP.

5. Written representations on behalf of the respondent were submitted by Ms Sarah Abel MSc, MRICS, a partner at Lawrence & Wightman, Chartered Surveyors, who also gave expert evidence before the FTT.

The appeal property and the lease

6. Hitchman Court is a converted three-storey 19th century vicarage which was extended in the 1980s by the addition of a three-storey wing. The accommodation comprises one-bedroom and studio flats.

7. Flat 23 is an unimproved first floor flat in the new wing comprising a living room, kitchen, bathroom and double bedroom. There is uPVC double glazing, laminate flooring throughout and electric storage heaters in the living room and bedroom. It has an area of 272 sq ft. There is an allocated car parking space.

8. Flat 23 was let for 99 years from 21 March 1984. The valuation date is 28 September 2015 at which time the lease had an unexpired term of 67.49 years. The parties agreed the capitalisation rate at 6% and the long (extended) lease value at £97,300. They also agreed that there was a price differential of minus 5% between ground/first and second floor flats in Hitchman Court.

The issues in dispute

9. Permission to appeal was granted on five grounds:

(i) that the FTT made an arithmetical error in its adjustment of comparable evidence;

(ii) that the FTT failed to make an adjustment to the existing lease value to reflect the benefit of the 1993 Act;

(iii) that the deferment rate determined by the FTT (5.75%) was too high;

(iv) that the FTT was wrong to make an adjustment (4%) in the value of the freehold interest for the risk of Schedule 10 rights under the Local Government and Housing Act 1989 being exercised at the end of the existing lease; and

(v) that the FTT failed to adjust the value of the extended lease upwards to give the freehold vacant possession value.

The FTT's decision

Issue (i): arithmetic adjustment

10. The FTT analysed the sale of a comparable at Flat 11 Hitchman Court in October 2014 for £80,750.

11. Flat 11 was located on the second floor of the original part of Hitchman Court and had restricted headroom to part of its floor area.

12. The FTT adjusted the sale price of Flat 11 at paragraph 63 of its decision:

"Although the Respondent suggested an uplift in values from 2014 to the valuation date, the Applicant suggested any uplift in value was counteracted by the reduction in the term of the lease. As such the Tribunal calculates:

Sale Price		£80,750
Adjustment for condition of subject property 5%	£4,037	
First floor location	£2,000	£ 6,037
		£86,787 accept £ 87,000

The Tribunal confirms a value [for the existing lease of Flat 23 with Act rights] of £87,000."

13. In its refusal to grant permission to appeal on this issue the FTT said:

> "The Respondent's bundle incorrectly stated that Flat 11 Hitchman Court was on the first floor and referred to the EPC for the flat. The EPC noted that Flat 11 Hitchman Court was in fact located on the second floor. This fact was agreed by the parties at the Hearing, as was the fact that Flat 11 would have restricted headroom due to its location in the building. The subject property is not disadvantaged by the lack of headroom and is located on the first floor. It was also noted by the Tribunal that Flat 11 only had single glazed windows. As such, the Tribunal finds that their adjustment for condition and location as an addition was correct."

Issue (ii): benefit of the Act

14. The FTT gave its conclusions on this issue at paragraphs 64 to 67 of its decision. It observed that the only reference to graphs of relativity was to the LEASE (Leasehold Advisory Service) graph which was based on decided cases before Leasehold Valuation Tribunals and had therefore already taken the benefit of the Act into account. The respondent relied on *Cadogan (Earl)* v *Cadogan Square Limited* [2011] UKUT 154 (LC) and *Sarum Properties Ltd v Cooley Stuart Webb & Others* [2009] UKUT 188 (LC). The FTT said that *Cadogan* involved a lease of just 17.75 years at which length "there is a question" about the impact of the benefit of the Act, while *Sarum* had not decided the point whether there should be an allowance for the benefit of the Act and had not disturbed the LVT's decision. The FTT said that both these cases "were some years ago" and that it preferred the evidence of Ms Abel on the issue.

15. The FTT summarised Ms Abel's evidence in paragraph 28 of its decision:

> "She believed that a 'No Act World' adjustment should not be made as, in her experience, purchasers in the market only had a vague knowledge of their rights to extend leases. If they considered the lease length at all, it was in terms of how long they might expect to own the property and whether or not they could obtain a mortgage."

Issue (iii): deferment rate

16. The FTT said at paragraph 59:

> "The dispute between the parties in respect of the deferment rate to be adopted essentially concerned growth rates and obsolescence. The Tribunal did consider that the evidence submitted by the Applicant regarding comparable growth rates to suggest that a *Zuckerman* adjustment was justified. In addition, the fact that the new extension was a concrete building (showing evidence of some damage to the flat), together with the fact that the inspection had revealed that there was some deterioration to the original building and there also appeared to be no reserve fund. The Tribunal agreed that an additional adjustment for obsolescence was justified. The Tribunal therefore adopts a rate of 5.75%."

Issue (iv): Schedule 10 rights

17. The FTT concluded at paragraph 68:

> "Whilst noting Mr McKeown's submissions, in the view of the Tribunal, the principle of an allowance for the possibility of an assured tenancy was established by *Re Clarise Properties Limited's Appeal* [2012] UKUT 4 (LC) and endorsed by [the] Upper Tribunal decision in *68 Mallaby Close*[1]. The Tribunal does, however, consider Mrs Abel erred in her assessment at 5% when the unexpired term is slightly longer than those in *68 Mallaby Close* and *18 Marine Drive*. As such, the Tribunal has adopted 4%."

Issue (v): freehold vacant possession value

18. The FTT concluded at paragraph 60:

> "The figure of £97,300 had been agreed by both parties, however the Respondent's valuer had proposed an uplift of 1% as a long lease could be regarded as 99% of virtual freehold. The Tribunal notes that this is not common practice in the Midlands and confirms the Extended Lease Value of £97,300."

Issue (i): arithmetic adjustment

19. The following factors are relevant to the analysis of the sale of Flat 11 as at the valuation date (28 September 2015):

(i) lease length;

(ii) the change in capital value between October 2014 (date of sale) and the valuation date;

(iii) size;

(iv) restricted headroom;

(v) floor level;

(vi) location - original building or the extension;

(vii) type of glazing; and

(viii) condition.

20. Ms Abel said that the first two factors, lease length and capital value change, were self-cancelling; the former decreasing the value of Flat 23 and the latter increasing it. The FTT did

[1] *Re Midland Freeholds Limited's Appeal* [2014] UKUT 0304 (LC)

not state in terms that it accepted Ms Abel's opinion on the point but this can be inferred from the wording of paragraph 63 of its decision and the fact that it made no adjustments for either time or lease length. The appellant does not challenge this finding in this appeal.

21. The appellant said that the FTT rejected its adjustment for size (Flat 11 being larger than Flat 23) because Flat 11 had partially restricted headroom and the FTT had treated these two factors as equal and opposite. But the FTT did not say in terms that it had taken these two factors as having no net effect on value in either its substantive decision or its refusal of permission to appeal. In her submissions in this appeal Ms Abel said the restricted headroom of Flat 11 was one reason why the FTT made an upward adjustment for condition when valuing Flat 23.

22. Three other factors might have influenced the FTT's findings about the relative condition of Flats 11 and 23: their location in the original building (Flat 11) or the newer extension (Flat 23); whether they had double-glazing; and the general physical condition of the two properties.

23. Ms Abel said there was no difference in value between the two parts of the building whereas Mr McKeown said the difference in value was "Original +10%". But Mr McKeown made no such adjustment when analysing Flat 11 as a comparable in his valuation report and it does not appear that the FTT made any adjustment for this factor.

24. The appellant wrongly stated that both Flat 11 and Flat 23 had single-glazing. The FTT, who inspected the appeal property, said at paragraph 18 of its decision that Flat 23 had double-glazing and I am satisfied from the photographs that this is so. This would require an upward adjustment to the value of Flat 11 by comparison.

25. The FTT found that the physical condition of Flat 23 was fair. Although it noted Mr McKeown's opinion that Flat 11 was in excellent condition there is nothing in its decision or its refusal to grant permission to appeal that justifies the appellant's statement in its grounds of appeal that:

> "The FTT agreed that an adjustment needed to be made for the superior condition of flat 11."

Ms Abel denied that the FTT had agreed with Mr McKeown on this point at the hearing.

26. The final factor to consider is that of floor level. The experts agreed before the FTT that a first floor flat was worth 5% more than a second floor flat. Notwithstanding this agreement the FTT only increased the value of Flat 11 by £2,000 or 2.5%. It gave no reason why the experts' figure had not been adopted.

27. It seems from the FTT's specific comments on this ground of appeal in its refusal to grant permission to appeal that its adjustment for the condition of the subject property was a figure

which reflected all of the eight factors listed above apart from the effect of the floor level which was considered separately.

28. The FTT's treatment of the length of lease and time adjustment as self-cancelling is not disputed. The restricted headroom of Flat 11 and the fact that it only had single glazing mean that its value should be adjusted upwards to give the comparable value of Flat 23. The larger size of Flat 11 means a downward adjustment. The FTT seems to have treated the original and new parts of the building as being of equal value and Mr McKeown's analysis does not contradict this. Although the FTT did not state in its decision that the physical condition of Flat 11 was better than Flat 23 there is no suggestion that it was worse. There should certainly be no upward adjustment to the value of Flat 11 to reflect the comparative physical condition of the two flats.

29. A 5% upward adjustment in value for what, in net terms, is the effect of uPVC double-glazing at Flat 23 is high in my opinion but as the FTT only made a 2.5% adjustment instead of the agreed 5% for the difference in floor levels between the two flats the overall upward adjustment of 7.5% is one which I consider the FTT was entitled to make on the evidence. The adjustment for "condition" was not, in my opinion, limited to a comparison between the physical condition of the two flats but involved a broader comparison as outlined above. The FTT did not make an arithmetic error but made adjustments that it was entitled to make on the evidence before it and from its site inspection. I therefore dismiss this ground of appeal.

Issue (ii): the benefit of the Act

30. The FTT preferred Ms Abel's evidence that there should be no adjustment for the benefit of the Act. Ms Abel said that purchasers would not distinguish between a lease with or without Act rights (and hence pay more for the former) since they did not know about or understand such matters and in any event were not concerned about them in their purchasing decision. It is hard to reconcile that argument with the facts of this appeal where Ms Smith purchased Flat 23 on 29 August 2013 and served a notice for a new lease two years later. I also note from the schedule of leases to the office copy of the freehold interest that several other leaseholders have extended their leases. That does not indicate ignorance of or disinterest in the 1993 Act. Ms Abel's approach also assumes that the vendor would be unaware of the ability of a lessee to extend their lease and would be prepared to accept the same price with or without the benefit of the Act. That assumption is, in my opinion, unsustainable.

31. Sales of leases without the benefit of the Act are, to all intents and purposes, hypothetical so there can be no direct comparison between sale prices with and without Act rights. But it has long been recognised by the Tribunal that having Act rights is a valuable benefit; see, for instance, *Nailrile Limited v Earl Cadogan* [2009] RVR 95 at paragraphs 216 to 217 and, more recently, *The Trustees of the Sloane Stanley Estate v Mundy* [2016] UKUT 0223 (LC) at paragraph 121. The amount of that benefit increases as the unexpired term reduces. It is beyond doubt that Act rights confer a benefit which is reflected in the value of leases in the actual market and which falls to be disregarded when calculating the premium payable for a new lease under the 1993 Act. This applies throughout England and Wales without exception; the West Midlands

is no different to any other region in this respect and the FTT gave no persuasive reason why it should be.

32. It follows that the FTT was wrong to accept Ms Abel's argument that there was no benefit of the Act in this case. In doing so the FTT distinguished *Cadogan* and *Sarum* and said that both cases "were some years ago" without explaining why that was relevant and what, if anything, had changed since 2009 (*Sarum*) or 2011 (*Cadogan*).

33. The only evidence of the effect on value of the benefit of the Act in this case was provided by Mr McKeown. In his written report he stated:

> "We are aware of an Upper Tribunal Decision where a 2.5% deduction was applied with 78 years remaining and another where 10% was deducted with 44 years remaining, the view of the Upper Tribunal being that the benefit of the Act on value increases as the lease gets shorter. On a straight line basis we can calculate the deduction at 4.6% for 67.49 years remaining."

The FTT said that the two decisions referred to by Mr McKeown were *Sarum* and *Cadogan* respectively but he did not identify them as such in his report.

34. The FTT correctly pointed out that Mr McKeown's reference to an unidentified Tribunal decision could not be a reference to *Cadogan* since that appeal was concerned with the valuation of a much shorter unexpired term where the allowance for the benefit of the Act was 25% and not 10%. The only Tribunal case of which I am aware that involved an unexpired term of 44 years was *Nailrile* where an adjustment of 7.5% was made for the benefit of the Act. In the more recent case of *Denholm v Stobbs* [2016] UKUT 0288 (LC), which post-dated Mr McKeown's report, the Tribunal considered the relativity of an unexpired lease of 43.37 years and assumed a 10% deduction for Act rights.

35. In the *Trustees of the Sloane Stanley Estate* the Tribunal (Morgan J and Mr A J Trott FRICS) gave the following guidance at paragraph 168:

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

36. The FTT was an expert tribunal able to express an opinion on the appropriate deduction for the benefit of the Act in this case. It noted that the Tribunal had accepted the FTT's decision in *Sarum* that a 2.5% deduction from the Act world existing lease value was appropriate for an unexpired lease of 77.7 years. Using that datum point and its specialised general knowledge it should have concluded that for an unexpired term of 67.4 years, i.e. 10 years shorter than the

lease in *Sarum*, the deduction for the benefit of the Act should have been higher. Mr McKeown's straight line interpolation which gave a figure of 4.6% was based upon an unidentified Tribunal case said to have allowed a 10% deduction for an unexpired term of 44 years. Taking a more cautious approach given the lack of clear evidence I consider that an allowance of 3.5% is appropriate. I determine the benefit of the Act in this amount rather than remit the issue to the FTT for further consideration.

37. The FTT endorsed Ms Abel's use of the LEASE graph as a check in support of the relativity derived from the existing lease value. This graph is contained in the "Published Research" section of the RICS Research Report "Leasehold Reform: Graphs of Relativity". In the *Trustees of the Sloane Stanley Estate* the Tribunal criticised and dismissed the College of Estate Management Graph which comprised data derived solely from LVT decisions. The LEASE graph is similarly constructed and I derive no assistance from it.

38. Ms Abel referred to the use of the LEASE graph by the Tribunal in *Re Coolrace Limited's Appeal* [2012] UKUT 69 (LC). But that decision was made "with some reluctance" and in the absence of any reliable transactional evidence. As such it was the only available option but the Tribunal stressed "that this decision should not be seen as setting a precedent in other cases where evidence which is much more reliable than the LEASE graph is available."

Issue (iii): the deferment rate

39. There are two elements to this aspect of the dispute:

(i) the growth rate; and

(ii) obsolescence.

(i) Growth rate

40. The FTT said that Ms Abel's evidence of rental growth justified an upward adjustment to the deferment rate of 0.5% in line with the Tribunal's decision in *Zuckerman v Trustees of the Calthorpe Estate* [2009] UKUT 235 (LC). That it is open to the FTT to treat the decision in *Zuckerman* as providing evidence in its own right relevant to the deferment rate appropriate to flats in the West Midlands was established in *Re Sinclair Gardens Investments (Kensington) Limited's Appeal* [2014] UKUT 0079 (LC). This decision was upheld on appeal ([2015] EWCA Civ 1247) where Lewison LJ said at paragraph 26:

> "Once one has arrived at the conclusion that a previous decision of the Upper Tribunal is admissible evidence of what is decided, then in the absence of guidelines laid down by the Upper Tribunal itself, it is a question of what weight a subsequent tribunal should give it."

41. The starting point when considering the appropriate deferment rate is *Earl Cadogan and Cadogan Estates Limited v Sportelli and Others* [2007] 1 EGLR 153 (LC); [2008] 1 WLR 2142

(CA) in which the deferment rate of flats was determined at 5% for properties in prime central London. Carnwath LJ said at paragraph 102:

> "That must leave the way open to the possibility of further evidence being called by other parties in other cases directly concerned with different areas."

42. The Tribunal noted in *Sinclair Gardens* at paragraph 75 that the Court of Appeal "did not suggest that the 'further evidence' which might be called in other cases would have to be especially cogent or compelling to justify a departure from those [*Sportelli* deferment] rates."

43. The Tribunal said at paragraph 76 that the further evidence required must provide a reliable indication of a long term movement in residential values. Furthermore "evidence relating specifically to data about the appeal property itself is also likely to be necessary, such as was available in *Zuckerman* and again in this appeal."

44. The Tribunal went on to say at paragraph 77 that "the evidence and representation on both sides in *Zuckerman* were of a much higher calibre than might ordinarily be expected in relatively modest cases." The Tribunal's conclusion in *Zuckerman* on comparative growth rates, informed as it was by published statistics, "was one which the LVT was entitled to take into account as part of the evidence before it in this case."

45. The deferment rate determined in *Zuckerman* cannot simply be adopted in other appeals in the West Midlands region as though it were a presumptive starting point. The correct starting point remains *Sportelli* and although *Zuckerman* can be taken into account it must be considered against specific evidence relating to the appeal property in question. In *Sinclair Gardens* the Tribunal stated at paragraph 74 that:

> "Another tribunal … which is asked in a subsequent case to consider and adopt the Tribunal's conclusions of fact as its own, will therefore be in a position to assess those conclusions in the light of the evidence it has heard for itself in its own case and decide whether it is persuaded by the totality of the material before it."

46. Ms Abel relied upon a comparison of the Land Registry House Price Index for Warwickshire, Birmingham and Greater London for the period January 1995 to March 2016 (although the valuation date was in September 2015). That showed house prices to have risen by 2.91 times, 2.48 times and 5.81 times respectively.

47. Mr McKeown made no reference to the deferment rate in his written report dated 17 November 2015. He just stated it to be 5%. The parties agreed that the original purchase price of Flat 23 in December 1984 was £17,200 and the FTT recorded Mr McKeown as having argued before it that the value of an extended lease of Flat 23 had therefore increased by 5.7% per annum "which was far in excess of the 2% adopted in *Sportelli*." In the light of that growth rate Mr McKeown told the FTT that no upward adjustment in the deferment rate was required for growth.

48. The evidence before the FTT, like that presented in *City & Country Properties Limited v Yeats* [2012] UKUT 227 (LC), can fairly be described as "very thin", not least because Ms Abel's comparison was with Greater London and not prime central London and was for a period of only 21 years. The evidence in *Zuckerman* provided data of price movements from the Nationwide (35 years) and Halifax (25 years) house price indices as well as details of price movements over 34 years in the subject block of flats in Edgbaston. This was then compared with price movements in prime central London over 32 years (Knight Frank).

49. Mr McKeown just relied upon an analysis of the price history of Flat 23 over 31 years. There was no evidence of price movements of other flats in Hitchman Court or any similar properties in the locality. Furthermore Mr McKeown's conclusion that the growth rate of Flat 23 substantially exceeded that in *Sportelli* overlooks the fact that in *Sportelli* the growth rate was 2% per annum *real* whereas Mr McKeown's annual growth rate for Flat 23 was expressed as a nominal rate. No like for like comparison was provided.

50. The annual increase in the price of Flat 23 (5.7%) is not materially different to the annual house price increase in Warwickshire (5.2%) which I derive from the submitted Land Registry Index data. That increase was significantly less than that of Greater London (8.5% pa) over the same period.

51. The Tribunal said in *Sinclair Gardens* that the further evidence justifying a departure from the *Sportelli* rate did not have to be especially cogent or compelling. The evidence in this case is, at least to some degree, consistent with the finding in *Zuckerman* that the difference between past rates of long term growth in prime central London and the West Midlands was not slight but considerable. This consistency in relation to common areas of fact, together with the FTT's specialist knowledge of the West Midlands region, satisfies me that it was reasonable for it to conclude that the deferment rate should be increased by 0.5% to 5.5%.

(ii) Obsolescence

52. The FTT based its decision to increase the deferment rate for obsolescence by 0.25% on three factors:

(i) The new extension was a concrete building showing some signs of damage;

(ii) The original building showed some deterioration; and

(iii) The lack of a reserve fund.

53. In *Sportelli* the Tribunal said at paragraph 91:

> "that it would only exceptionally be the case that such factors [obsolescence and condition] were not fully reflected in the vacant possession value and the risk premium. Evidence would be needed to establish that they were not fully reflected in this way."

This was emphasised in *Sinclair Gardens* where the Tribunal said at paragraph 82 that:

> ".. Any such allowance must be based on the characteristics of the particular property which is under consideration. The passages we have cited above from *Sportelli*, *Hildron* and *The Holt* emphasise that it will be in exceptional cases that the risk of deterioration will not be reflected in the vacant possession value of a property. Something more than age or a current poor condition is required to justify any additional allowance."

54. The FTT based its decision upon the observed characteristics and condition of Hitchman Court following a site inspection. Unlike the subject maisonette in *Sinclair Gardens*, Hitchman Court cannot be said to be "typical of thousands of similar age and construction." It appears to be unusually constructed being a converted and extended former vicarage. I think it was open to the FTT to treat the subject property as an exceptional case where the risk of deterioration is not reflected in the freehold vacant possession value. I am therefore satisfied that it was reasonable for the FTT to allow an addition of 0.25% to the deferment rate for the risk of obsolescence and deterioration making a total deferment rate of 5.75%. I therefore dismiss this ground of appeal.

Issue (iv): Schedule 10 rights

55. The FTT deducted 4% from the freehold vacant possession value to reflect the risk that the landlord might not obtain vacant possession upon expiry of the lease because of the possibility the tenant might remain in possession under an assured tenancy under Schedule 10 to the Local Government and Housing Act 1989.

56. Mr McKeown said that the fact that (i) the FTT found there to be a risk of obsolescence at the subject flat that was not reflected in its freehold vacant possession value; and (ii) Ms Abel had given evidence that it was much less economically viable to repair properties in the West Midlands than prime central London meant that "there is a certain or very strong likelihood that at the end of 67 years the property will be developed by the landlord." Mr McKeown said that "the tenant will have no rights to stay on if the landlord intends to redevelop the site." Therefore an allowance of 4% for the risk of the tenant remaining in possession at the expiry of the lease was unwarranted.

57. Mr McKeown did not explain the basis of his assumption that the tenant would have to vacate the property if the landlord wanted to redevelop the site. The existing lease of Flat 23 was a long lease at a low rent granted on 20 December 1984. As such it is a tenancy to which section 186(3) of the Local Government and Housing Act 1989 applies and which is defined under paragraph 1(6) of Schedule 10 to that Act as a "former 1954 Act tenancy".

58. The redevelopment ground upon which a landlord may rely in claiming to resume possession at the term date of the tenancy is contained in paragraph 5(1)(a) of Schedule 10 to the 1989 Act which in turn refers to ground 6 of Schedule 2 to the Housing Act 1988. But paragraph 5(2) of Schedule 10 states that the said ground 6 may not be specified in a landlord's notice to resume possession if the tenancy is, as here, a former 1954 Act tenancy. Paragraph 5(1)(b) of

Schedule 10 is also a redevelopment ground but paragraph 5(4) provides that this may not be specified as a ground to resume possession unless the landlord is a body to which section 28 of the Leasehold Reform Act 1967 applies which is not the case here.

59. I have found nothing to support Mr McKeown's assumption that the landlord would be able to repossess Flat 23 at the expiry of the original term on the grounds of redevelopment.

60. Mr McKeown says, in the alternative, that at the end of the original lease term the landlord would apply for an order for possession under section 61 and Schedule 14 of the 1993 Act and that consequently there would in practice be no risk of the tenant remaining in possession under an assured tenancy.

61. In essence Mr McKeown is saying that an upward adjustment to the deferment rate to allow for a greater risk of obsolescence is at odds with a downward adjustment to the freehold vacant possession value to reflect the possibility of the tenant remaining in possession under an assured tenancy.

62. I do not agree that section 61 is relevant where a new lease is yet to be granted under the 1993 Act. The premium payable by the tenant in respect of the grant of a new lease is the diminution in the value of the landlord's interest, being the difference between the value of the landlord's interest in the tenant's flat prior to the grant of a new lease and the value of his interest in the flat once the new lease is granted.

63. Section 61 is concerned with the landlord's right to terminate the *new* lease on the grounds of redevelopment. That right has no effect on the value of the landlord's existing interest which is to be valued on the basis that there are no rights to acquire a new lease. The FTT's Schedule 10 adjustment reflects the possible position at the end of the *existing* lease and the risk to the landlord of the tenant being granted an assured tenancy. In any event the prospect of a section 61 application may well be reflected in the value of comparable long leases since such leases are often new leases granted under the 1993 Act.

64. I do not understand Mr McKeown to be saying that section 61 would be relevant to the valuation of the proposed interest with a reversion to a higher development value following the making of a successful section 61 application. The landlord's case is not pleaded that way and there is no evidence to support it.

65. Mr McKeown's final argument is that a purchaser of the freehold subject to the existing lease would not be concerned about the possibility of the tenant remaining under an assured tenancy at the end of the lease where the term does not expire for another 67 years. He said that, in any event, an assured tenancy would justify a nil or much lower discount than were the tenant able to remain under a statutory tenancy under the Rent Act 1977.

66. Ms Abel's evidence on the point consisted of reference to previous FTT and Tribunal decisions which she described as "precedents". In *Vignaud v Keepers and Governors of John Lyons Free Grammar School* (1996) 71 P&CR 456 the Tribunal, His Honour Judge Rich, said at 459 in connection with a dispute about whether there should be a deduction for the tenant's 1954 Act rights to a statutory tenancy:

> "… It must be clearly understood that the proper deduction for this right must be a matter of evidence or argument. It is not a matter to be determined by convention or derived from the decisions of Tribunals on other evidence and other facts."

67. In the present case the FTT found that there was a risk of obsolescence that was not reflected in the freehold vacant possession value and that there should be an increase of 0.25% in the deferment rate to allow for this. So there is the possibility that as the lease draws to its end it would no longer be economically viable to repair the property and that there would be an increased risk of its deterioration. It is then necessary to consider whether a tenant whose leasehold interest had expired would wish to remain in possession of a property which was in relatively poor condition, where he could be faced with a dispute about unfulfilled repairing obligations and would have to pay a market rent in accordance with the 1988 Act.

68. In my opinion the FTT should also have directed itself to these factors rather than focus solely upon previous FTT and Tribunal decisions from which it derived its discount of 4%. Given the existing lease had an unexpired term of 67 years it was unlikely that a hypothetical purchaser would have made a significant deduction for Schedule 10 rights in the circumstances described and, in my opinion, a nominal discount of 2.5% would have been appropriate. I therefore determine the Schedule 10 allowance in this amount.

Issue (v): freehold vacant possession value

69. The FTT did not accept that the value of the extended leasehold was 99% of the freehold vacant possession value because this adjustment was "not common practice in the Midlands". Ms Abel said there was no demand for freehold flats in Leamington Spa because (i) there was a lack of mortgage finance; and (ii) there was an inherent difficulty in enforcing positive covenants. She said that "in a relatively immature market such as the Midlands, it is not something that is ever taken [into] consideration when agreeing lease extension premiums."

70. It is generally recognised that there is a qualitative difference between freehold and leasehold tenure and that a leasehold, however long its term, is not as valuable as an equivalent freehold. The relativity of even the longest lease may approach 100% but will not reach it. This valuation principle is reflected in many Tribunal decisions and in *Earl Cadogan v Erkman* [2011] UKUT 90 (LC) the Tribunal set out an appropriate range of relativities at paragraph 98:

> "Leases with unexpired terms of 100 to 114 years - 98%; 115 to 129 years - 98.5% and above 130 years - 99%."

71. The majority (but not all) of the graphs in the RICS Research Report "Leasehold Reform: Graphs of Relativity" show relativities of 100 year leases which are less than 100%. One graph that equates a 100 year lease with a freehold is that produced by Nesbitt & Co. In *Mallory v Orchidbase Limited* [2016] UKUT 0468 (LC) the Tribunal accepted the evidence of Mr Laurence Nesbitt of that firm that "in his experience a share of the freehold would make little difference to value when considering long lease values." The Tribunal found support for that view in the price achieved for a long leasehold flat which was higher (on a time adjusted basis) than the prices of three other flats in the same block each of which had a share of the freehold.

72. In many cases before the Tribunal the relativity of a long lease is agreed between the parties and is unlikely to be disturbed, e.g. in *Denholm* the parties agreed, and the Tribunal accepted, that an extended 133.37 year lease had a relativity of 99%.

73. It may be the FTT's experience in the Midlands that parties tend to agree the relativity of long leases at 100% although the reasons given by Ms Abel why this is so and her suggestion that the Midlands market is "immature" are not explained or convincing. Mr McKeown challenged the FTT's assertion that it was "not common practice" to discount the relativity by 1% and, in the absence of any evidence of the kind that persuaded the Tribunal in *Mallory* not to make such an allowance, I see no reason why such a discount should not properly have been made by the FTT, in accordance with Tribunal practice and valuation principle. I therefore allow this ground of appeal and determine the relativity of the extended lease at 99% of the freehold vacant possession value.

Determination

74. I determine the issues in this appeal as follows:

Issue (i): arithmetic adjustment - appeal dismissed;

Issue (ii): the benefit of the Act - appeal allowed in part. Benefit of the Act determined at 3.5%;

Issue (iii): the deferment rate - appeal dismissed;

Issue (iv): Schedule 10 rights - appeal allowed in part. Allowance reduced to 2.5%;

Issue (v): freehold vacant possession value - appeal allowed.

75. The premium to be paid by the tenant for the new lease shall therefore be £8,300 calculated in accordance with Appendix 1 attached.

Dated 16 May 2017

A J Trott FRICS

APPENDIX 1

FLAT 23 HITCHMAN COURT: UPPER TRIBUNAL'S VALUATION

Valuation date: 28 September 2015

	£	£	£
1. **Diminution in value of freeholder's interest**			
(i) *Value of existing freehold*			
Initial ground rent	30		
x Y.P. 1.49 years @ 6%	1.386		
		42	
Reversion to increased ground rent	60		
x Y.P. 33 years @ 6%	14.230		
x PV of £1 in 1.49 years @ 6%	0.917		
		783	
Reversion to increased ground rent	120		
x Y.P. 33 years @ 6%	14.23		
x PV of £1 in 34.49 years @ 6%	0.134		
		229	
		1,054	
Reversion to freehold vacant possession value (£97,300/0.99)	98,283		
Less 2.5% allowance for Schedule 10 nights	2,457		
	95,826		
x PV of £1 in 67.49 years @ 5.75%	0.023		
		2,204	
		3,258	
(ii) Value of proposed freehold interest			
Freehold vacant possession value	98,283		
x PV of £1 in 157.49 years @ 5.75%	.00015		
		15	
Diminution in freehold value			£3,243

2. **Marriage Value**	**£**	**£**	**£**
(i) Value of proposed interests			
Freehold	15		
Leasehold	97,300		
		97,315	
(ii) Value of present interests			
Freehold	3,258		
Leasehold (£87,000 less 3.5% for benefit of the Act)	83,955		
		87,213	
Marriage value		10,102	
Freeholder's share of marriage value @ 50%			5,051
Premium			8,294
Say			8,300