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RESIDENTIAL PROPERTY TRIBUNAL SERVICE

LEASEHOLD VALUATION TRIBUNAL

For

THE LONDON RENT ASSESSMENT PANEL

Ref: LON/LVT/1803/04

DECISION on an APPLICATION UNDER SECTION 21 of the LEASEHOLD REFORM ACT 1967 ('the Act')

APPLICANT: (1) **Bircham & Co. Nominees (No.2) Limited**
(2) **Sarah Elizabeth Stowell**

RESPONDENT: (1) **Martin Christopher Clarke**
(2) **Shaneen Clarke**

PROPERTY: **13 South Terrace, Kensington, London SW7**

HEARING: **14 December 2004**

APPEARANCES:

For the Applicant:

Mr Edwin Johnson

Mr Bernard D'Monte

Mr Roland Cullum, FRICS, FIRPM

Counsel

Bircham Dyson Bell

Cluttons

For the Respondent:

Mr Robin Sharp, BSc, FRICS, IRRV

MEMBERS OF THE TRIBUNAL:

Mr John Hewitt

Mrs Jennifer McGrandle

Mr Luis Jarero

Chairman

BSc(EstMan), MRICS, MRTPI

BSc, FRICS

Notice of Tenant's Claim dated:

18 May 2004

Tenant's proposed price: £696,573

Landlord's Notice in Reply dated: 12 July 2004

Landlord's proposed price: £906,000

Valuation Date: 18 May 2004 (agreed by the parties)

Details of Tenant's Existing Lease:

Date: 29 April 1981

Parties:

- (1) Martin James Pollock,
Ernest John Ward Barnes,
John Patrick Riversdale Glyn
Alan Edward Oliver
- (2) Barry Dalton
Valerie Ann Dalton

Term: From 29 April 1981 to 25 December 2026

Unexpired term at valuation date: 22 years and 7 months

Ground rent: £94 pa

Tribunal's Decision:

Price: £822,464

Date: 15 March 2005

1. Introduction

1.1 This is an application made pursuant to s21 of the Act.

1.2 The Applicant reversioner seeks a determination of the price to be paid by the Respondent for the freehold interest in the Property. The Applicant has admitted the Respondent's entitlement to the freehold. We are told that all other matters concerning the transfer of the freehold have been agreed save for costs, which the parties are content to deal with separately. Thus the only issue for the Tribunal is the price to be paid.

1.3 The hearing was held on 14 December 2004. The Applicant was represented by Mr Edwin Johnson of counsel. Mr Roland Cullum gave evidence as an expert on the question of valuation.

The Respondent was represented by Mr Robin Sharp who also gave evidence as an expert on the question of valuation.

1.4 Prior to the hearing the valuers had exchanged their respective reports; there was no agreed statement of facts. Subsequent to the hearing, both parties filed written closing submissions.

1.5 In essence the differences between the valuers are as follows:

| | Reversioner (Mr Cullum) | Tenant (Mr Sharp) |
|----------------------------|------------------------------------|------------------------------|
| Price | £906,000 | £696,573 |
| Freehold value | £2,137,500 | £2,000,000 |
| Current lease value | £1,000,000 | £1,150,000 |
| Capitalisation rate | 6.5% | 6% |
| Deferment rate | 5.25% | 6% |

1.6 The Property comprises a substantial terraced house laid out on basement, ground and three upper floors, giving a gross internal area of 2,716 sq ft.

In broad terms the accommodation provides:

Basement: sitting room, bedroom, bathroom/wc, utility room and vaults

Ground floor: hall, wc, dining room, kitchen

First floor: drawing room

Mezzanine: bathroom/wc

Second floor: master bedroom/bathroom suite

Third floor: three bedrooms

The Property enjoys a small rear garden.

The Property is illustrated and described in more detail in the reports of Mr Cullum and Mr Sharp.

The Property is Grade II listed and situate in the Smith's Charity/Thurloe Conservation Area. It is also within an Estate Management Scheme.

It is common ground that the Property is situated in a fashionable and sought after area of prime central London, but that it suffers from a degree of noise nuisance from the tube line which runs in the open a short distance from the rear garden.

The Tribunal inspected the Property, comparable properties and the location generally on 15 December 2004.

1.7 The lease is in fairly standard form but it contains an absolute prohibition against alterations and also against assigning or subletting to a company as follows:

'2(7) Not to make any alteration or addition externally or internally to the demised premises or remove any partitions doors or cupboards or other fixtures or fittings therein or any architectural feature thereof including in particular and without prejudice to the generality of the foregoing any stucco mouldings cornices architraves doors panels or ceilings and not to cut maim or alter any of the main walls or timbers thereof and in particular and without prejudice to the generality of the foregoing not to alter or damage obscure or allow to deteriorate any stucco mouldings cornices architraves doors panels ceilings or other architectural features which form part of the distinctive period features of the demised premises which are a building listed as being of architectural or historic interest pursuant to the Town and Country Planning Act 1968...'

- '2(9)(i) Not to assign underlet part with or share possession of any part or parts of the demised premises less than the whole*
- (ii) Not to assign or underlet the demised premises to any body corporate or any unincorporated body or association or part with or share possession of the demised premises with the same*
- (iii) Subject as aforesaid and subject also to due compliance with Clause 5 hereof:*
- (a) Not to assign part with or share possession of the whole of the demised premises without the prior written consent of the Lessors such consent however not to be unreasonably withheld in the case of a respectable and responsible person who shall enter into a direct covenant with the Lessors to observe and perform all the covenants on the part of the Lessee and the conditions herein contained*
- (b) Not to underlet the demised premises furnished or unfurnished except on terms that do not require the payment of a fine or premium or the provision of any services to the underlessee and require the underlessee to observe and perform all the covenants on the part of the Lessee (other than the covenant for the payment of rent) and the conditions herein contained and to pay an annual rent exclusive of outgoings of not less than five times the rent from time to time payable pursuant to the terms of this Lease and further to obtain the Lessors' consent to any assignment of the term created by any such Underlease (which shall not be unreasonably withheld in the case of a respectable and responsible assignee thereof who shall enter into a direct covenant with the Lessors to observe and perform all the covenants on the part of the underlessee and the conditions contained in the Underlease) such*

Underlease also to contain an absolute covenant prohibiting any further underletting of the demised premises by way of a derivative term created out of any term of years granted by such permitted Underlease (which shall not in any event exceed seven years) and shall contain a provision requiring notice of all assignments of the term created by any such underlease to be given to the Lessors' Solicitors and the deed or document effecting such assignment to be produced for registration with them and their registration fee of Ten pounds plus Value Added Tax paid

Provided Always however that each such underletting shall require the consent of the Lessors which shall not be unreasonably withheld to an Underlease on the terms hereinbefore set out to a respectable and responsible person'

2. Freehold Value

2.1 Mr Cullum relies on transactions within South Terrace as follows:

| No. | Date | Price | GIA | £/psf | Adj £psf (to valuation date) |
|---|-------|---------|-------|--------|---------------------------------|
| Freehold Sales | | | | | |
| 2 | 12/01 | £1.8m | 2,309 | £780 | £872 |
| 22 | 07/01 | £2.3m | 2,421 | £950 | £983 |
| 8 | 01/04 | £2.375m | 2,550 | £931 | £968 |
| 2 | 10/04 | £2.4m | 2,343 | £1,024 | £1,031 |
| 16 | 04/04 | £2.850m | 3,012 | £946 | £946 |
| Leasehold Sale (22 years 7 months) | | | | | |
| 13 | 05/04 | £1.25m | 2716 | £460 | £766 (adj to f'hold 60%) |

Mr Cullum adjusted the sale of the leasehold interest in the Property in May 2004 at £1.25m (with an unexpired term of 22 years and 7 months) by 60% in order to arrive at his value of the freehold at £2.08m (£766psf).

Mr Cullum calculated the average £psf for the even numbered properties at £964. Mr Cullum acknowledged that the even numbered properties did not back onto the tube line and thus did not suffer the noise nuisance from it.

2.2 Mr Cullum said that apart from the Property there were no market transactions concerning odd numbered properties in South Terrace within the last 3 years.

However, 4 such properties were currently on the market with details as follows:

| No. | Tenure | Adj to F'hold | Asking Price | GIA | £/psf | Adj £/psf |
|-----|----------|------------------|-----------------|-------|--------|-----------|
| 15 | 52 years | 82% | £2.175m | 2,851 | £762 | £929 |
| 7 | F'hold | | £2.5m | 2,686 | £930 | £930 |
| 17 | F'hold | | £2.65m | 2,897 | £914 | £914 |
| 11 | F'hold | | £3.95m | 3,376 | £1,170 | £1,170 |

Mr Cullum calculated the average asking price to be £985psf which he discounted by 10% to reflect probable selling price to arrive at £887psf. He said this was about 8.5% below the average price £psf for the even numbers and reflected the tube line noise nuisance.

Mr Cullum assumed that all the comparables were modernised to a greater extent than the Property and discounted a further £100psf to reflect this. Mr Cullum thus arrived at a value of £787psf which at 2,716sq ft values the freehold interest in the Property at £2,137,500.

2.3 Mr Sharp, in support of his figure of £2m as the unimproved freehold value, quoted the freehold sales of Nos. 2, 8 and 16 South Terrace which he analysed respectively at £1,024, £915 and £946 psf. He regarded No.8 as being a better guide to the Property's value than No.16 and stated that the sale price of No. 2 would need to be discounted to reflect the fact that it was in immaculate condition with features superior to No.13. He undertook a similar exercise for Nos. 8 and 16.

3. Leasehold Value

3.1 The lease of the Property was sold with the benefit of the statutory notice to the Respondent in July 2004 at a price of £1.25m. Mr Johnson, for the Applicant, submitted that the price had to be adjusted to reflect the value of:

1. the benefit of the right to enfranchise
2. the benefit of the notice of enfranchisement served in May 2004 and the fixing of the valuation date, and
3. the benefit of the ability to free the Property, by enfranchisement, from the onerous alienation and alterations covenants.

Mr Cullum adjusted the price by £250,000 (20%) and Mr Sharp by £100,000 (8%).

3.2 Mr Cullum analysed the May 2004 open market sale and then referred to the use of relativity indices and graphs. He supported his discount by contending that in the absence of market evidence of the sales of leases with and without the benefit to enfranchise, it was necessary to resort to a theoretical exercise founded in commonsense and probabilities. He suggested that as the lessee was statutorily entitled to 50% of the marriage value, a vendor was unlikely to sell at a price which gave up the whole of that share to the purchaser, and a purchaser would be reluctant to buy at a price which included the whole of that share. He suggested that the lessee's half share would be shared equally, that is to say the adjustment was 25% of the marriage value. Mr Cullum demonstrated his theory with a worked example. Applying that theory to this case Mr Cullum arrived at 'no Act world' figure of £1,100,000. He adjusted further to reflect the fact that notice had been given and the purchaser did not have to await the 2 year qualifying period, and the purchaser had the ability to be able to carry out works to the Property, which was in need of modernisation, without having to go the landlord for approval. There was no precise way to value such benefits, but Mr Cullum was of the opinion that a discount of a further £100,000 was about right. Thus he got to £1,000,000 for the leasehold value. For an unexpired term of about 22 years, the various graphs produced, he stated, a range of leasehold values as a % of freehold values from 41% to 56%. His resulting figure of 46.8% (£1m over £2.1375m) in his view adequately reflected the benefit of the notice and the draconian lease terms.

3.3 Mr Sharp considered that the adjustment should only be £100,000. His principal reasons were:

1. The benefit of acquiring the freehold was less in a static market.
2. The service of a notice stopped time running. Again, this benefit was less in a static market.
3. No premium for the notice was paid in the present case because of the landlord's likely attitude to a negotiated settlement and the risks, cost and uncertainty

of protracted negotiations. A property with the benefit of a valid notice under the Act was in his experience difficult to sell.

4. Mr Sharp did not consider that freeing the Property from onerous lease terms would have any material benefit. Whilst in need of modernisation the Property was perfectly usable in its current configuration. The Estate Management Scheme and town planning controls were restrictive in themselves.

Mr Sharp thus put the 'no Act world' valuation at £1,150,000.

4. Yield

Capitalisation Rate

4.1 Mr Cullum adopted a figure of 6.5% as determined in the Shawfield Street case (Lands Tribunal ref: LRA/27/2003) heard by Mr N J Rose FRICS and where his decision was given on 16 April 2004.

Mr Sharp contended for 6% as being a long established figure for prime central London.

Deferment Rate

4.2 In support of his figure of 5.25% Mr Cullum relied on three sources:

1. He said that returns were falling in the rack rented sector. He relied upon separate data issued by Investment Property Databank (IPD) and FPDSavills (FPDS) which he said showed net yields of 2.4% to 3.3%.
2. The Shawfield Street decision, in which the Lands Tribunal had determined a deferment rate of 5.25%. He stated that Shawfield Street was not as prime an investment as the subject Property, which prima facie would command 4.75% at its most prime, but that he discounted 0.5% for the impact of the tube line on the odd numbers in South Terrace and accordingly had adopted 5.25%, and
3. Evidence of settlements achieved by his firm at below 6%, mostly he stated at 5.25% following the Shawfield Street lead.

4.3 Mr Sharp, in support of his figure of 6%, relied on two recent LVT decisions (Flat at 8 Cadogan Square SW1 (LON/NL 2398/04) and 6 Pelham Street SW7 (LON/LVT/1671/03)) where 6% was determined in each case. He stated that the Shawfield Street decision had to be seen in the light of recent interest rate rises and a static market. Further, in any analysis of settlement evidence it had to be borne in mind that lessees were interested only in their particular case, not the broader picture pursued by reversioners in their wish to push up values.

5. Decision and Findings

Freehold Value

5.1 Both valuers applied a number of essentially subjective adjustments in order to arrive at their respective figures. Their valuations are relatively close and within valuation tolerance as acknowledged by Mr Johnson.

5.2 Both valuers acknowledge that the odd numbered side of South Terrace is less valuable than the even numbered side due to the presence of the tube line. However, the only evidence of market transactions was on the even side.

5.3 Adjustments therefore have to be made, not only for condition, size, position within the terrace and date, but also for the presence of the tube line. There were properties for sale on the odd numbered side, which Mr Cullum sought to analyse, but the Tribunal preferred to concentrate on the actual prices achieved by transaction.

5.4 The average sale price of the 5 transactions on the even numbered properties was £964psf. Making appropriate adjustments for condition and position, and for the tube line, which the Tribunal considers requires a discount of 10%, we come to a figure of £768psf. This equates to a freehold value of £2.085m.

5.5 We therefore decide that the freehold value is £2.085m.

Leasehold Value

5.6 Both valuers started with the leasehold sale of the Property which completed in July 2004 at £1.25m with the benefit of the statutory notice. The question to be determined therefore is the discount to be applied to reflect the benefit of the notice and the fact that onerous lease terms would be released.

5.7 Again, the valuers are relatively close, Mr Cullum at £1m and Mr Sharp at £1.15m. In coming to his figure, Mr Cullum discounted £250,000 for 'no Act world' and onerous lease terms. Mr Sharp discounted £100,000 for 'no Act world' but nothing for onerous lease terms because, in his view, he did not consider that the lease terms had any impact on value.

5.8 The Tribunal preferred the evidence of Mr Cullum on this point, which echoed the experience of the members of the Tribunal that the benefit of the notice would carry more weight than Mr Sharp attributed to it, even in a static market. Further, the Tribunal considered that the onerous lease terms would restrict the market for the Property because of the potential cost and the inherent risk of delay in seeking and obtaining the necessary consents.

5.9 Mr Cullum sought to confirm his figure by reference to the graph of graphs produced by him which, he said, showed relativity within the range of 41% to 56%. The Tribunal reviewed the graph and considered Mr Cullum's figure to be on the low side and perhaps the range was 46% to 61%. Whichever band might be the more accurate both bands were so broad that the Tribunal did not consider that any weight could be given to the graph.

5.9 Balancing the evidence and the expertise and experience of the members of the Tribunal, the Tribunal considers that the value of the leasehold interest is £1m. And therefore determines this figure.

Yield

Capitalisation

5.11 The valuers are again very close, Mr Cullum at 6.5% and Mr Sharp at 6%. The Tribunal was told that whatever figure is determined, it will not have a material effect on the ultimate valuation in this case. Mr Johnson, in his final written submissions invites the Tribunal to 'split the difference'. The Tribunal did not consider this to be the correct approach to take on this occasion.

5.12 The Tribunal is of the view that 6% is the correct rate to apply because this a long established market rate for prime central London property.

Deferment

5.13 Mr Cullum relied upon 3 sources to support his rate of 5.25%, namely:-

1. Investment yields in the rack rented sector
2. The Shawfield Street decision
3. Settlement evidence

We shall take each in turn.

1. Rack rented sector.

The Tribunal was not persuaded that a comparison with yields said to be achievable in the rack rented sector was helpful or appropriate evidence. It is the experience of the members of the Tribunal that the IPD and FPD Savills data is based on standard

residential property let on assured shorthold tenancies and specifically excludes ground rent income. The indices are a measure of short term performance and short term yield which could quite easily be low because investors have not been able to achieve the rents they had hoped for or have suffered longer void periods. In times of falling rents and increasing capital values, the figures can be unreliable guides. The Tribunal considers that the market sees a freehold reversion, especially in prime central London, as a long term investment not influenced by short term trends whatever may be happening in the residential property sector. We do not therefore consider that the performance of the rack rented sector is material to the deferment rate to apply in this case.

2. Shawfield Street decision

5.14 Mr Cullum then sought reliance on the Shawfield Street decision. The Tribunal notes that this decision was given in April 2004 in a case where the valuation date was 11 June 2002. Since that time there have been 5 increases in interest rates. The Tribunal is not confident that the decision in Shawfield Street is a reliable guide to the deferment rate to be applied to the subject Property with a valuation date of May 2004.

3. Settlement evidence

5.15 Finally Mr Cullum relies upon his settlement evidence. Mr Sharp criticised the settlement evidence on the basis that leaseholders were mainly interested in the price they had to pay for their lease extension or freehold and had little interest in the manipulation of component parts of the calculation. Mr Sharp also asserted that in the market place some reversioners were willing to reach an accommodation on one or more component parts in order to be able to demonstrate achieving a certain factor on another component part. This is perhaps illustrated by the some of the letters produced by Mr Cullum. The Tribunal particularly have in mind pages 64, 68 and 71 of the trial bundle. In particular at p68 Mr Charles Boston says '*I am prepared to give you 5.5% in this instance in order to reach a settlement.*'

At p71 the writer says '*You have advised us that as a condition of the settlement of this matter you require confirmation on the part of our clients that they agree the deferment rate at 5.5% and we confirm that purely for the purpose of settling this matter we are instructed by our clients that they so agree.*'

5.16 Accordingly the Tribunal has determined a deferment rate of 6%.

5.17 The Tribunal's valuation, determining an enfranchisement premium of £822,464, is attached as Appendix 1.



John Hewitt
Chairman
15 March 2005

Leasehold Valuation Tribunal

Ref: Lon/LVT/1803/04

Valuation of 13 South Terrace

| | |
|---------------------------|-------------|
| Value of existing lease | £1,000,000 |
| Value of freehold | £2,085,000 |
| Capitalisation rate | 6.00% |
| Deferment rate | 6.00% |
| Valuation date | 18 May 2004 |
| Length of lease remaining | 22.6 yrs |

Valuation of Freeholder's current interest

| | | | |
|-----------------------------|------------|-----------------|----------|
| Ground rent received | £94.00 | | |
| YP 22.58yrs @ 6% | 12.2005 | £1,147 | |
| Reversion to freehold value | £2,085,000 | | |
| PV of £1 in 22.6 years @ 6% | 0.2680 | <u>£558,780</u> | |
| Total | | | £559,927 |

Calculation of Marriage Value

Value of proposed interests

| | | |
|------------|------------|--|
| Tenant | £2,085,000 | |
| Freeholder | <u>£0</u> | |
| | £2,085,000 | |

Value of existing interests

| | | |
|------------|-----------------|--|
| Tenant | £1,000,000 | |
| Freeholder | <u>£559,927</u> | |
| | £1,559,927 | |

| | | | |
|----------------|--|-----------------|----------|
| Marriage value | | <u>£525,073</u> | |
| 50% | | | £262,537 |

Premium payable to Freeholder **£822,464**