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HM COURTS & TRIBUNALS SERVICE
RENT ASSESSMENT COMMITTEE
MIDLAND LEASEHOLD VALUATION TRIBUNAL

BIR/00CT/OAF/2011/0091

In the matter of 36 Melton Avenue, Solihull, B92 8HP;

Leasehold Reform Act 1967, Sections 9, 21(1) (ba)

Mr Patrick O'Grady

Applicant

and

Coolrace Limited

Respondent

Date of notice:-

31st August 2011

Date of application:-

11th November 2011

Date of hearing:-

2nd April 2012

Tribunal:

Mr J.H.L. de Waal
Mr. R. Brown FRICS
Mr. S. Berg FRICS

Attendances:

For the Applicant:
For the Respondent:

Mr. A.W. Brunt FRICS
Mr. S.H. Prichard FRICS

DECISION

1. This is the Tribunal's decision on Mr. O'Grady's application for determination of the price payable under section 9 of the Leasehold Reform Act 1967 ("the Act") for the house and premises at 36 Melton Avenue, Solihull B92 8HP ("the Property") and for determination of the amount of any costs payable under sections 9 and 21(1)(ba) of the Act.

The Application

2. The notice is dated 31st August 2011 and was served on the Respondent, Coolrace Limited, on 13th September 2011. The Respondent served no counter notice. The application was issued on 11th November 2011.
3. The Property is held under a lease dated 24th February 1938. The term of the lease is 99 years from 29th September 1937 at a rent of £5.75 per annum.
4. The Tribunal inspected the Property on 2nd April 2012. It is a semi-detached house with a porch, hall, through living room, galley style kitchen and conservatory on the ground floor. On the first floor there are two double bedrooms, a single bedroom and a bathroom. There is a small foregarden, a rear garden and a garage.

The hearing

5. At the hearing the Applicant was represented by Mr Brunt and the Respondent by Mr Prichard who had both provided helpful and detailed written submissions. We also heard evidence from Mr Martin Ward FCCA on issues relating to the deferment rate.
6. By the date of the hearing the parties had agreed the entirety value at £170,000.
7. In issue were the following:

(1) The capitalisation rate – the Applicant submitted this should be 7.0%; the Respondent 6.5%;

(2) Site apportionment – the Applicant submitted this should be 32.0%; the Respondent 33.33%.

(3) The deferment rate – the Applicant submitted this should be 5.5%; the Respondent 4.25%;

(4) Whether the standing house value should include a deduction of 20% to reflect the tenant's right to remain in occupation at the term of the lease.

(1) Capitalisation rate

8. In his written submissions to the Tribunal Mr Brunt referred us to a number of previous decisions of this Tribunal which determined that an appropriate capitalisation rate was 7.0%. Mr Prichard suggested that it should only be 6.5%. Although the difference was marginal, we considered that, given the low and fixed nature of the ground rent, a capitalisation rate of 7.0% was appropriate.

(2) Site apportionment

9. Mr Brunt again referred us to a number of relevant recent decisions of this Tribunal which suggested at the appropriate figure for this plot was 32%. Mr Prichard submitted it should be 33.33%.
10. We consider that in the light of the recent fall in land values and greater volatility, the percentage site apportionment will be lower than it was previously. There is support for this conclusion in the light of the evidence gleaned from comparable decisions to which we were referred. In the circumstances we considered that 32% was the correct apportionment in this case.

(3) Deferment rate

11. Mr Prichard submitted that the deferment rate in this case should be 4.25%. In doing so he relied upon the expert opinion of Mr Martin Ward. Mr Ward's opinion was that the risk free rate of 2.25% determined by the decision of the Lands Tribunal in Sportelli LRA/50/2005 should be reviewed and reduced in the light of the fact that there has been a significant and steady decline in the rates for gilts since that decision.
12. Although the Sportelli decision does not apply directly to valuations under section 9(1) of the Act, or outside Prime Central London properties, it remains a useful guide and starting point for consideration of this issue. For properties in the West Midlands guidance is given by the decision in Zuckerman and Others v Trustees of the Calthorpe Estate LRA/97/2008, sometimes known as 'Kelton Court'.
13. There are three elements to the deferment rate: (i) risk free rate less (ii) real growth rate plus (iii) risk premium.
14. Thus starting point for the calculation of the deferment rate is Sportelli subject in this case to the modifications of 0.5% (lower real growth outside PCL) and 0.25% (depreciation and obsolescence). Although no new evidence was introduced in this case, it is now generally accepted that, in the Midlands area, a higher deferment rate should be adopted. Thus; the starting point for the Tribunal's determination is as follows:

Section 9(1)				
<i>Sportelli</i>	Risk Free			2.25
	Real Growth		minus	<u>2.00</u>
			equals	0.25
	Risk Premium	4.50		
<i>Zuckerman</i>	Poorer growth outside the PCL	0.50		
	Obsolescence and Depreciation	0.25	equals	<u>5.25</u>
Deferment rate				5.50%

15. Mr Ward pointed out the date of the decision in Sportelli, there had been a significant and steady decline in the rates for gilts. Further in Sportelli, he said, insufficient regard had been had to appropriate maturity matching (i.e. matching the term of the stock used to the unexpired term of the lease). A risk free rate of 2.25% was set in Sportelli against a general backdrop of a 5 year rolling average over 10 years of indexed gilts rather than, in Mr Ward's opinion, the more relevant longer dated real gilts. It was now, in his view, appropriate for a 'step change' to take place basing the rate to reflect the returns on investments with similar maturity dates.
16. Mr Ward's analysis using dated stock (2016, 2055 and 2035) showed for the period post July 2006 to July 2010 a 'flat lining' of rates at just below 1.00.% with a further steeper fall to the valuation date in August 2011. This rate was approximately 1.25% below the rate 2.25% rate adopted in Sportelli using the rolling basis.
17. On this basis, particularly supported by the Bank of England data on real gilt yields, Mr Ward said that a downward adjustment of the real risk free element of the deferment rate was long overdue and accordingly the risk free rate should be adjusted to 1% and following through to a deferment rate of 4.25%.
18. We raised with Mr Ward the question of why he had not addressed the other elements of the Deferment Rate, namely real growth rate and the risk premium. His explanation was that real growth was long term and there was no evidence to consider a change. We agree with this. The Lands Tribunal in Sportelli said at para. [72]: "*we think realistic or neutral, assumption would be 2%*". We were not given any evidence that might lead to a different conclusion.
19. However, Mr Ward was unable to persuade us that he had considered (and discarded) any consideration of the risk premium. Whilst satisfied that there was no reason to reconsider the real growth rate, we were not satisfied that in seeking to alter one part of the deferment rate matrix it was not necessary to consider the other elements particularly the risk premium

(volatility, illiquidity, deterioration and obsolescence). Since Sportelli there has been evidence of a rising rate of return on residential property investment (rising rents against falling or level prices). At para. [76] in Sportelli the Lands Tribunal said: *“Tradability would, we think, be important as one of its components, and it is this that would make the volatility of the housing market and the relative illiquidity of the investment significant factors in the mind of a purchaser”*.

20. Although we see some merit in Mr Ward’s argument that the maturity date of stock is relevant he had not convinced us that it was appropriate to move away from the ‘five year rolling basis’ method adopted in Sportelli to more ‘maturity date based’ approach. We refer to and adopt the reasoning set out at para. [70] in Sportelli in particularly the point that whilst it is unnecessary to match the length of the record to the length of the unexpired term in order to arrive at a representative long-run risk-free rate: *“(b) It is however necessary to choose a period sufficient to avoid, or to be capable of allowing for, distortions such as the so-called ‘pensions panic’ which three of the experts agree is presently distorting the bond market.”*
21. In fact, it seems to us that it is arguable that in the present market of falling or stable house prices and rising rents there is justification for saying that the risk premium could be revised upwards thus cancelling out any downwards adjustment of the risk free rate. We refer to para. [73] in Sportelli.
22. For these reasons we are not persuaded that the deferment rate here should be anything other than 5.5%.

(4) Deduction for tenant’s right to remain in occupation

23. Mr Brunt referred us to a recent decision of the Upper Tribunal Clarise Properties Limited [2012] UKUT 4 (LC) in which, in an enfranchisement case, the Lands Chamber deducted 20% from the standing house value to reflect the fact that the tenant had the right to remain in occupation after the term of the lease 50 years hence, and the freeholder therefore was not

certain to obtain vacant possession. The reasoning in that case is set out at paras. [39] – [40] of the judgment. Mr Brunt submitted that a similar deduction should be made in this case.

24. In this case the unexpired term is 25 years. Based on the reasoning in Clarise, we agree that a deduction is appropriate and, with some reservation, adopt 20%.

The decision

25. Our calculation of the price payable therefore proceeds as follows:

Valuation

Ground rent p.a.	£5.75	
YP 25 yrs @ 7.0%	<u>11.6536</u>	
		£67.01

1st Reversion

Entirety Value	£170,000.00	
Site apportionment @ 32.0%	£54,400.00	
Section 15 rent @ 5.5%	£2,992.00	
YP 50 yrs 5.5%	16.9315	
	50,659.05	
PV £1 in 25 yrs 5.5%	<u>0.2622</u>	
		£13,282.80

2nd Reversion

Standing House Value	£170,000.00	
80% to allow for tenant rights	£136,000.00	
PV £1 75 years 5.5%	<u>0.0180</u>	
		£2,448.00
Price	£15,797.81	
(say)		<u>£15,797.00</u>

26. We therefore determine that the price payable for the acquisition of the freehold under section 9 of the Act shall be £15,797.
27. In relation to the application under section 21(1)(ba) of the Act we consider that the Freeholder's reasonable legal costs should be £400 and the reasonable legal costs £350, exclusive of VAT.

17 MAY 2012

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Date



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John de Waal
Chairman, Midland
Leasehold Valuation Tribunal