

LONDON RENT ASSESSMENT PANEL

**DECISION OF THE LEASEHOLD VALUATION TRIBUNAL ON AN APPLICATION
UNDER THE LEASEHOLD REFORM, HOUSING AND URBAN DEVELOPMENT
ACT 1993, SECTION 24**

Case Reference: LON/00BG/OCE/2012/0171

Premises: Sapphire Court, 1 Ensign Road, E1 8QJ

Applicant: Sapphire Court Freehold Limited

Respondent: Freehold Managers (Nominees) Limited

**Leasehold Valuation
Tribunal: Mr M Martynski (Solicitor)
Mr R Humphrys FRICS
Ms N Dhanani LLB (Hons)**

Date of hearing: 5 February 2013

**Representatives
at the hearing: Mr P Beckett FRICS (Applicant's valuer)
Mr A Mason FRICS (Respondent's valuer)**

Date of decision: 15 February 2013

Decision summary

1. As to the only valuation point of dispute between the parties, the Tribunal concludes that the appropriate Capitalisation Rate is 6.75%

Background

2. Sapphire Court ('the Building') is a purpose built block containing 29 one and two bedroomed flats. The flats are all let on very long leases of 999 years from 24 June 1998. There is a management company which is party to the leases and which takes care of all management and insurance. Given the position regarding the length of the leases and the management, the only real value in the freehold is the ground rent income.

3. The ground rents (for the Building as a whole) are:

£4,300.00 p.a. for the first 25 years
£8,600.00 p.a. for the first 25 years
£12,900.00 p.a. for the first 25 years
£17,200.00 p.a. for the first 25 years
£21,500.00 p.a. for the first 25 years

4. Very unusually therefore, the only issue between the parties, and the only issue which this decision needs to address¹ is the Capitalisation Rate on the ground rent.

The valuation background

5. The parties' valuers helpfully produced a table for the Tribunal. That table set out a series of Capitalisation Rates from six to eight per cent (in quarter percentage steps) and for each step set out the rounded valuation figure for the freehold produced by that percentage.

The Capitalisation Rate – evidence, arguments and the Tribunal's decisions

6. The Capitalisation Rates argued for by each valuer were; 8% for Mr Beckett (Applicant) and; 6.5% for Mr Mason (Respondent).

7. The Tribunal considers the correct Capitalisation rate to be 6.75%.

8. The Tribunal came to this figure by considering the following issues.

Comparables

9. Mr Mason for the Respondent set out in his report details of two valuations that he had agreed on collective enfranchisements in November and December 2011. In both cases the Capitalisation Rate was agreed at 6%. In one case the rents were reviewable every 10 years (993 years unexpired) and the increase was based on the index published by Nationwide Building Society. In the other the rents were reviewed every 21 years (114 years unexpired) with reference to capital values of the flats. He concluded that the rate in this case before this Tribunal should be 6.5% to reflect the fact that the rents in the comparables were dynamic as opposed to rents in the subject building which are subject to fixed increases.

10. The Tribunal considered these comparables to be of some, albeit limited use. The Tribunal also considered it relevant, as one factor in coming to a decision on the correct percentage, that Mr Mason's experience of Capitalisation Rates was that settlements on Capitalisation Rates of around six to six and a half percent were common.

¹ There may be an issue on the terms of the transfer or on the ground rents for garages, if there is any further issue, the parties have been given leave to raise this with the Tribunal

11. Mr Beckett for the Applicant relied on his analysis of just one transaction which was ongoing as at February 2013. This transaction was in respect of a property at Stanhope Terrace in W2. The rents for that property had fixed increases and so were not dynamic. In this case Capitalisation was, Mr Beckett believed, only part of the value of the freehold. The actual purchase price agreed was never broken down or analysed between the parties. Mr Beckett dealt with the valuation aspects of this transaction himself. He says that the purchasers were particularly interested in the management and insurance of the building. From this interest, he assumed that the purchaser considered that there was value in the management and insurance. Mr Beckett did not know the details of how the purchaser valued or broke down the value of the freehold interest.
12. Mr Beckett assumed the income from management and insurance to be valuable but not reliable. The value he attributed to the two incomes was; £3,396 plus VAT p.a. for the management, and; 25% of the insurance premium - added together amounting to £6,000 p.a. He gave these income streams a price by applying five years' purchase valuation. Such a valuation produces a figure of £30,000. This was deducted from the purchase price. The only other element of value in the freehold was the ground rents. In this way Mr Beckett considered that he was getting to the true value of the ground rents in the freehold. This analysis of the sale (based on a deferment rate of 5.25%) gave a Capitalisation Rate of 7.89% which Mr Beckett rounded down to 7.5%.
13. That's all very well, but this deconstruction of the purchase price assumes that the management fee is pure income and that the insurance commission, even if lawful, is very large at 25%.
14. Only a part of the management fee will actually be profit (this was, at least partially, recognised by Mr Beckett in his report). In order to earn that management fee, work actually has to be done and people have to be paid to do that work. There may be other overheads that need to be covered.
15. As to the insurance commission, 25% is of course normally the top limit of commission earned. If commission were paid, it is likely that it would be less than 25%. More importantly however is the question mark over the legality of a lessor taking the commission for itself on sums that have been purely paid by the leaseholders². If the commission were paid in respect of services provided by the landlord - i.e. claims handling (unlikely in most cases), then again, work would have to be done and overheads paid to earn that commission and so the commission figure would be gross, not just a pure net income stream. Further, is it in any event proper for a Tribunal to have regard to a valuation that gives a value to, what may be, an unlawful gain for a landlord?
16. Further the Tribunal considers that the possibility of the tenants seeking to manage the building themselves must be a factor to be taken into consideration in this transaction.

² Southwark LBC v Tornaritis [1999] C.L.Y. 3744 Lambeth County Court

17. It is therefore very arguable that there is little value in the management and insurance in the example given by Mr Beckett. If there were little value, the effect of this on the supposed Capitalisation Rate in that case is to reduce the notional rate to below 8%.

The Union Wharf case

18. Both parties had had regard to a previous decision of a Leasehold Valuation Tribunal dated 13 November 2012 - *Union Wharf, 23-25 Wenlock Street, N1 7SE – LON/00AM/OCE/2012/0042*. Mr Mason thought the decision to be relevant and one to which the Tribunal should have regard.
19. There were various valuation issues in *Union Wharf*, one of them being the Capitalisation Rate which was, unusually, very significant in this case and was in fact the biggest element of the valuation in dispute.
20. In *Union Wharf* (where the rents were fixed) the Tribunal considered the correct capitalisation rate to be 6.5% The Tribunal in that case took into account;

- The length of the lease terms
- The security of recovery
- The size of the rents
- The existence of rent review provisions
- The nature of rent review provisions

That Tribunal heard evidence from valuers as to comparative markets and heard from them as to their general experience as to the levels of settlements in respect of Capitalisation Rates.

21. Mr Beckett urged the Tribunal to have no regard to this case arguing that no weight should ever be given to decisions of a first tier tribunal.
22. Mr Beckett is largely correct in that each first tier Tribunal's decisions will turn largely on their own facts and that, in any event, one such tribunal's decisions cannot bind another's (even if the composition of the tribunal is the same or similar). Clearly the details of the factors taken into consideration in the *Union Wharf* case are different to this case (i.e. different lease terms, different rents etc.). However, the general factors themselves are relevant and will always be relevant to capitalisation. Further, this Tribunal is entitled to have regard to (amongst other matters); the fact that a previous tribunal has come to a Capitalisation Rate of 6.5% in a case where there are fixed, non-dynamic rents, and; the fact that that tribunal heard evidence as to the percentages agreed on Capitalisation Rates in the experience of both valuers (in that case the valuers being particularly well regarded in their field).

Settlement evidence

23. Mr Beckett reminded the Tribunal of the dangers of relying on settlement evidence. The Tribunal is mindful of those dangers but such evidence in the form of actual settlements and the general experience of valuers nonetheless can play a part, but only a part, in the Tribunal's decision making process.

Mr Beckett's own analysis

24. Mr Beckett, in his report, sought to rely on two grounds in support of his Capitalisation figure. First, his comparable discussed above and second, his own analysis set out in his report and put into the form of a table.
25. In his analysis Mr Beckett considered that the following matters should be considered;
26. *The difference between fixed escalating rents and dynamic rents:* At between £500 to £5,000 per annum (which is the band into which this case falls) Mr Beckett considered that the Capitalisation Rate for fixed rents was 8%, and for dynamic was 9% (at block, rather than individual flat level).
27. *Frequency of review:* For reviews that were more than 20 years apart (as in this case) there would be no deduction from the rate of 8%.
28. *Collectability:* Again for range of between £500 and £5,000 p.a. (block as opposed to individual flat level), there would be no deduction from the 8%.

Conclusions

29. The Tribunal agrees with Mr Beckett's consideration as to the relevant factors as between different kinds of rent. It disagrees however with the percentages used and the percentage parameters.
30. The only evidence for the 8% upper parameter on the non-dynamic £500-£5,000 range is the one comparable relied upon by Mr Beckett³. The Tribunal prefers the evidence of Mr Mason in respect of settlements and experience. The Tribunal has also had regard to the Union Wharf decision and considers that the upper figure of 8%, argued for by Mr Beckett, is too high.
31. The Tribunal is however concerned that, on Mr Mason's case, the difference between the percentage for a fixed rent and a dynamic rent is too small at half a percent. There are of course many different types of dynamic rents but in general, assuming a dynamic rent that is reasonably problem free, the Tribunal considers that a three-quarter point is more appropriate.
32. The Tribunal has therefore taken Mr Mason's 6% base figure and added to that three-quarters of a percentage point to arrive at 6.75%.

³ Of course if Mr Beckett's assumed income figures for this comparable are reduced, this figure would be lower in any event

33. The Tribunal is conscious that this result is different to *Union Wharf*. That is explained by two factors. First, as stated above, a previous Tribunal decision can be taken into account but generally only as one of many factors; second, the Tribunal's decision must generally be based on the evidence and expert opinions⁴ given to it in any particular case which may well be different to those in another case.



.....
Mark Martynski
Tribunal Chairman
15 February 2013

⁴ Provided there is no reason to believe that those expert opinions should not be given weight – most certainly not the case in this application