2910

FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case References	:	**LON/00AG/OLR/2013/1595** **LON/00AG/OLR/2013/1364**
Properties	:	**Raised Ground Floor Flat and First Floor Flat** **20 Fitzjohns Avenue, NW3 5NA**
Applicants	:	**Caddy Ocean Limited (First Floor)** **Fors Fortis Limited (Ground Floor)**
Representative	:	**Katharine Holland Q.C. instructed by Lewis Silkin Solicitors**
Respondents	:	**Rafael Bloomberg & Esther Bloomberg**
Representative	:	**Mr A Radevsky instructed by NC Law Solicitors**
Type of Application	:	**Grant of new lease (Section 48 Leasehold Reform, Housing and Urban Development Act 1993**
Tribunal Members	:	**Mr M Martynski (Tribunal Judge)** **Ms S Redmond BSc(Econ) MRICS**
Dates and venue of Hearing	:	**10 & 11 June 2014** **10 Alfred Place, London WC1E 7LR**
Date of Decision	:	**17 July 2014**

DECISION

Decision summary

1. The Tribunal decides that the premiums to be paid for new leases in respect of the Raised Ground Floor Flat and the First Floor Flat are to

be calculated in accordance with the report and view of Mr Lester for the Respondents and accordingly the premiums payable are:
Raised Ground Floor: £765,175.14
First Floor: £601,617.77

Background

2. 20 Fitzjohns Avenue ('the Building') is a substantial semi-detached Victorian house converted into five flats. There is a large garden at the rear of the Building in respect to which the flats have shared access.

3. The Raised Ground Floor Flat has its own entrance. The First Floor Flat is accessed by a communal front door and hallway leading to the three upper flats.

4. The chronology of these claims is as follows:

Claim Notices	
Raised Ground	19 February 2013 (proposing £484,000)
First Floor	15 July 2013 (proposing £323,574)
Counter-Notices	
Raised Ground	26 April 2013 (proposing £1,170,510)
First Floor	23 September 2013 (proposing £1,170,000)
Dates of application to the tribunal	
Raised Ground	18 October 2013
First Floor	3 December 2013

5. Relevant details of the leases are as follows:-

Raised Ground	10 October 1926 for a term of 67 ¾ years (less 3 days) from 25 March 1962 Unexpired term at valuation: 16.83 years
First Floor	30 June 1926 for a term of 67 ¾ years (less 3 days) from 25 March 1962 Unexpired term at valuation: 16.43 years

6. The freeholders of the Building are the Respondents. There is an intermediate head leasehold interest held by I Katz Limited under a lease dated 23 March 1948 for a term of 82 years from 25 December 1947.

The parties' respective positions

7. The parties' opening positions at the hearing are summarised as follows:-

Issue	Applicants' position	Respondents' position
Extended lease value Raised Ground First Floor	 £1,450,000 £1,125,000	 £Agreed £Agreed
Relativity Raised Ground First Floor	 48.25% 47.44%	 39% 38.5%
Deferment Rate	5%	5%
Capitalisation Rate	5.5%	5.5%
Premium Raised Ground First Floor	 £764,725.35 £633,555.89	 £495,000 £386,500

The parties' experts

8. The Applicants relied upon valuations carried out by Mr Peter Beckett FRICS and contained in his report dated 5 June 2014.

9. The Respondents relied upon valuations carried out by Mr Andrew Lester MRICS and contained in his report dated 3 June 2014.

10. Both experts gave evidence at the hearing. Mr Beckett submitted revised valuations after the hearing which incorporated various matters that arose during the hearing.

The issues and the evidence

11. There were four points of principle disputed between the experts as follows:

    (a) Whether adjustments should be made to reflect the condition of the Building
    (b) Whether the freehold vacant possession value in the statutory valuation should be valued as a 'flying freehold'
    (c) Whether the concept of 'principled relatively' should be adopted in the valuations
    (d) Whether there should be any discount on the landlord's interest for the risk that vacant possession will not be available at the end of the lease term

The condition of the Building

12. Mr Beckett considered that the well-advised purchaser would have made some enquiry into the condition of the building. He relied on an undated report from Harris Associates. No individual's name was put

to this report. The report had been obtained by the intermediate landlord. The summary to the report states as follows:-

> Externally, 20 Fitzjohns Avenue is in an average aesthetic condition and requires repairs to the roof tiles, flat roofs, windows, rainwater goods and a full redecoration package. There are signs of structural defects and other defects through out the property, mainly in the form of cracking and water ingress. Generally, the building is tired and there are elements which are beginning to deteriorate and if left will gradually decline. We would advise that an external works project should be undertaken within the next 12 months ideally during the summer or latter part of 2014.

13. Mr Lester in his report described the Building as follows:-

> On both occasions when I inspected the property is the exterior of the main building was generally adequately presented with no significant defects present.

14. We inspected the Building after the hearing. We found the exterior of the building to be in reasonable decorative order. We could not see any obvious signs of disrepair. The communal stairs and hallway leading to the upper flats were in reasonable condition.

15. Mr Beckett considered that the sum of £50,000 should be taken from the very long lease value to reflect the cost of the works required to the Building as set out in the report from Harris Associates. He came to this figure by taking the costs refers to in that report of £237,000, taking 20% to represent each flats individual contribution under the service charge and round the resulting figure up.

16. Mr Lester did not consider that the condition of the Building would cause a purchaser to make such a reduction. He was concerned that the Harris report was very general, the language used was very 'woolly' with lots of use of the term 'allowances'. He conceded that a purchaser would be likely to obtain a survey prior to purchase, but in his view, such a survey would be unlikely to consider in detail the overall condition of the Building and the possible costs associated with works to the Building.

Freehold vacant possession value being valued as a 'flying freehold'

17. On this point, the Applicants made reference to the wording of paragraph 3(1) to Schedule 13 Leasehold Reform, Housing and Urban Development Act 1993 ('the Act') which is as follows:-

> **3.—**
> (1) The diminution in value of the landlord's interest is the difference between—
> (a) the value of the landlord's interest in the tenant's flat prior to the grant of the new lease; and
> (b) the value of his interest in the flat once the new lease is granted.

18. The actual wording of the Act, it was argued, required the valuation of the landlord's reversionary interest *'in the tenant's flat'*. The literal

meaning of the Act is therefore that one has to assume a notional sale of the freeholder's interest in the flat alone – thereby creating a flying freehold.

19. Mr Beckett dealt with the problems associated with a flying freehold in his report. That there are significant problems with a flying freehold was not a matter that was directly disputed by Mr Radevsky for the Respondents.

20. As to the value of a flying freehold, Mr Beckett says as follows in his report:-

> The very rarity of this situation in the real world makes it particularly difficult to assess what kind of discount would be necessary to sell the flying freehold..... [paragraph 2.4.1]
>
> They are surely would be some adventurous, entrepreneurial type of buyer who, if the discount was great enough, would buy into this deeply unsatisfactory situation..... [paragraph 2.4.2]
>
> I have not been able to engage in dialogue in relation to this case, or indeed any other to date, to test in debate what the appropriate discount would be, but I think it would be enormous. I therefore select 50% as a rough and ready discount to reflect this serious disability. [paragraph 2.4.3]

21. Mr Radevsky made the point that valuations pursuant to this part of Schedule 13 of the Act had never been done before on the basis of a flying freehold. If the Applicants were right on this point, it would apply to almost every new lease claim under the Act and would mean that all the valuations done (assuming they did not value pursuant to a flying freehold) under the Act since it came into force would have been incorrect.

22. He went on to argue that the clear statutory purpose of this part of the Act was to compensate a landlord to the extent of the value of his reversion to the existing lease for an additional 90 years. The reality of the situation is that the landlord (when the freeholder) remains at all times the freeholder of the whole. Parliament did not intend to penalise a freeholder by the grant of a new lease with the assumption that part of the freehold would now be held separately from the remainder of the building.

23. Mr Radevsky pointed out that paragraph 3(4) of the Schedule allows appropriate market assumptions to be made in assessing the price realised on the sale of the landlord's interest. The obvious assumption to be made therefore is that the landlord would sell his entire freehold interest rather than create, to the detriment of himself and any future owner, a flying freehold.

24. Reliance was placed on *Arbib v Earl Cadogan* [2005] 3 EGLR where, says Mr Radevsky, the flying freehold argument was raised and rejected, paragraph 161 of the judgment summarises the matter as follows:-

> 161 We do not, however, think that Schedule 13 does require the assumption of a flying freehold. We accept that paragraph 3(2)(a) does have that effect. We accept however Mr Gallagher's submission that paragraph 3(4) entitles the vendor to have it assumed that the reversion upon the relevant lease was sold only together with the freehold interest in the rest of the block.

25. This approach, argued Mr Radevsky, is in line with the approach in *Nailrile Ltd v Earl Cadogan* [2009] 2 EGLR 151, a case which concerned the valuation of a intermediate lease. It was also consistent with the approach in a case decided under the Leasehold Reform Act 1967, *Re Castlebeg Investments (Jersey) Ltd* appeal [1985] 2 EGLR 209 where the valuation of a single freehold reversion could be valued more highly as part of a lot with others, where that produced a higher amount in the market.

26. Ms Holland Q.C. did not accept that there was any authority against her valuation proposition. She referred to *Arbib* and argued that the plain statement at paragraph 159 (quoted above) supported the Applicant's view. She pointed out that the context of the discussion from which quotes have been taken was different in *Arbib* as the topic being discussed was Deferment rates.

27. As to *Nailrile*, Ms Holland relied on the fact that this was a case concerning an intermediate interest which is dealt with under paragraph 7 of Schedule 13; there is no reference to '*in the flat*'.

28. As for *Castlebeg*, that, argued Ms Holland, could not be relevant as it concerned a completely different Act with similar, but not exact wording.

29. Moving on to the assumptions that can be made in paragraph 3(4) of Schedule 13, Ms Holland's view was that the assumptions argued for by Mr Radevsky were not possible. The reason for this was that the basis of valuation set out in paragraph 3(1) is paramount. Paragraph 3(4) allows only appropriate assumptions. That therefore excludes an assumption that is not consistent with the clear wording of paragraph 3(1).

30. Mr Beckett cited two authorities in his report to illustrate the Upper Tribunal's thinking on the matter. First he referred to the case of *City& Country Properties Limited v Yeats* [2102] UKUT 227 (LC). In relation to that case, Mr Beckett said that the Upper Tribunal raised the question of why no valuer had noticed that FHVT in the statutory evaluation was, or ought to be, the value of a flying freehold. Ms Holland conceded that this case was not authority for the flying freehold proposition and that the tribunal simply state at paragraph 27 that no arguments have been raised on the issue. The Tribunal said:-

> This case is concerned with the extension of a lease upon a single flat. As seen from Schedule 13 of the Act, a crucial ingredient in premium to be paid is diminution in value of the landlord's interest in the flat. Paragraph 3 of

Schedule 13 states how to determine this diminution in value of the landlord's interest. In the present case this exercise would appear to require examining the amount which the freehold in a single flat in Bishopric Court (a block of 55 flats) might be expected to realise on certain assumptions.

31. The other authority was *Hauser v Howard de Walden Estate Ltd* [2013] UKUT 0579. In that case all the parties and the tribunals dealt with the valuation of the freehold as a flying freehold. Mr Radevsky argued that the reason why the valuation was for a flying freehold is because of the particular nature of the building in that case. The building looked like a house but had a smaller basement footprint creating, physically, a flying freehold.

Principled Relatively

32. According to Mr Beckett, the Act envisages a world which does not exist, has not existed, and could probably never exist– a world in which landlord and tenant cannot confer together to transact to mutual advantage. Accordingly, in determining Relativity, market evidence from and expert opinion as to the real world has no place.

33. Mr Beckett takes support for this view from some comments by the Court of Appeal[1], in a discussion about Deferment Rates.

34. Mr Beckett therefore produced a graph based upon two points. The first point sits 0% which is the relativity at zero years unexpired. The point at the other end of the graph at 100 years is 98%, that being the figure that, according to Mr Beckett, everyone agreed was appropriate for 100 years. The graph is then plotted between these two points on the principle that the rate of decay of the lease is consistent throughout its term.

35. Such a graph could only be used for prime Central London, defined as a market which is not mortgage dependent. As it transpired both experts were in agreement that the Building is situated in a non-mortgage dependent area. However, in his report Mr Beckett dealt with the possibility that tribunal may conclude that the Building is in a mortgage dependent area. In that eventuality Mr Beckett, in his search for the correct relativity figure, looked at his own firm's mortgage dependent graph, which of course was compiled using evidence from the real world. He allowed that if he were wrong about Principled Relativity, that Relativity figure would then lie somewhere between the relativities he has adopted and that of his own firm's graph.

36. Mr Radevsky pointed out that Mr Beckett's concept of Principled Relativity was raised and rejected in a Leasehold Valuation Tribunal

[1] *Cadogan v Sportelli* [2007] EWCA Civ 1042

decision and permission to appeal the LVT on that issue was refused by the Upper Tribunal[2].

37. Mr Radevsky challenged Mr Beckett's assertion that everyone agrees that relativity at 100 years is 98%. If this is not necessarily the case, then any change to that percentage figure produces a significant change in the figures further down the curve on the principled graph.

38. Mr Lester, for the Respondents, adopted a more traditional approach to the question of the value of the short leases. He starts off by noting that the best evidence of relativity would be the sales of identical properties at the same time in the same location. He notes that this is of course complicated by the no-Act rights requirement. Mr Lester referred to the case of *38 Cadogan Square* [2011] UKUT 154 (LC) where the approach of taking an actual value of a short lease in the real world and making a percentage deduction for Act rights was discussed. A table is produced in the judgment showing percentage reductions for Act rights which, it was said, would assist to a limited degree.

39. Mr Lester then looks at the sales of both short leases in the subject flats -Raised Ground in March 2013 and First Floor in August 2013.

40. For the Raised Ground Mr Lester indexes for time and then, considering the percentages in the Graph produced in *38 Cadogan Square*, he settles on a figure of 26%.

41. For the First Floor Flat, Mr Lester is unhappy with the sale price in August 2013 which he considers too high. He adjusts this figure based on an analysis of the sale figure for the Raised Ground Floor Flat. Again, with regard to the *38 Cadogan Square* table, he applies a reduction of 26.5% to the adjusted figure to arrive at his 'no-Act world' value for the short lease.

42. Having carried out this exercise, he arrives at Relativity figures of 36.65% (Raised Ground) and 37.14% (First Floor). He notes that these figures are lower than most of the various graphs of Relativity. He then considers that one of the reasons for this may be that the area in question lies on the outer edge of a non-mortgage dependent area where short leases are unusual. Therefore, Mr Lester has regard to the various graphs set out by My Leasehold Ltd and adjusts his figures having regarding to those graphs to 39% for the Raised Ground and 38.5% for the First Floor.

---

[2]*Alexander Voyvoda v Grosvenor West End Properties* [2013] UKUT 0334 (LC) – although this is the substantive appeal from the LVT decision, it does not deal with the question of Principled Relativity

Discount on the landlord's interest for the risk that vacant possession will not be available

43. It was argued on behalf of the Applicants that there were three risks to be taken into consideration:-
    (a) Lessee obtains an Assured Tenancy (only possible with a change in the law to increase the rent limit from £25,000 to £100,000)
    (b) The tenant claims that the rental value is below £25,000 and the matter has to be determined by a First-tier Tribunal.
    (c) The tenant remains in occupation unlawfully and legal proceedings have to be brought to obtain vacant possession

44. Mr Beckett allowed 10% for this in his report but in cross-examination conceded that the figure should be more in the region of 7.5%.

45. In reply to this point, Mr Radevsky argued that there have been very few tribunal decisions where there has been a discount for such a risk, and then only where the existing lease is very short, and the rental value will not exceed the statutory limit. Mr Radevsky pointed out that even if there were a short tenancy at the end of the lease, such a tenancy would be at a market rent and would not by any means be a disaster for the freeholder.

Conclusions and decisions

46. Given the experience and standing of the experts and of Counsel in this case and the very full submissions put to us, and given the level of this tribunal, we do not consider that any detailed analysis of our own of the matters in dispute is going to be helpful. The conclusions that we have drawn from the evidence and submissions put forward and our decisions on the issues in dispute are therefore briefly as follows.

The condition of the Building

47. As stated above, on our inspection of the Building, we found no obvious sign (on a visual inspection from street level, front and rear) that the Building required immediate maintenance and repair or that maintenance and repair would be an issue of particular concern bearing in mind the fairly regular maintenance required to a building of this period.

48. As to the report from Harris Associates relied upon by Mr Beckett; we were concerned that there was no indication as to the person who complied the report and so we have no idea of that person's qualifications. We are also concerned that the report was in fairly general terms. We were not supplied with details of the instructions provided for the report nor was there a specification works with the report. For those reasons, we have decided to give the report very limited weight.

49. We consider that a purchaser at the relevant time probably would have commissioned a survey of some kind. Even if that survey had highlighted the need for repair and decoration of the exterior and common parts, that work would probably not have been costed.

50. Further, we consider that given the regular maintenance and repair required by a property of this nature and given its size, a purchaser would factor in the need for regular expenditure on maintenance and repair. In a relatively buoyant market[3], we consider therefore that there would be no deduction made in respect of repairs and maintenance.

Freehold vacant possession value being valued as a 'flying freehold'

51. We agree that the literal wording of paragraph 3(1) of Schedule 13 to the Act requires a valuation of what effectively is a flying freehold. However, we consider that the purpose of the Act is to provide for a scheme to fairly compensate freeholders. If the only way to avoid the literal meaning of paragraph 3(1) is to make an assumption that the landlord would not create a flying freehold for sale (and if one is going to make an assumption of this kind, that is the only sensible conclusion to reach) then the Act should be interpreted as to allow such an assumption under paragraph 3(4).

52. Even though the court in *Arbib* was dealing with Deferment Rates when it commented on this part of Schedule 13, its comments were very clear and appeared to indicate a very firm practical approach for Schedule 13 generally.

53. In Nailrile, a case dealing with an intermediate leasehold interest, there were further clear statements, for example:-

> Although what has to be valued is the ILI [intermediate leasehold interest] as defined in paragraph 1 [of Schedule 13 to the Act] and although the value is to be ascertained on the basis of a sale by a hypothetical seller to a hypothetical buyer, it is not, in our judgment, the effect of the provisions that, if in reality the ILI would not (or indeed could not lawfully) be sold in isolation, such an isolated sale must be assumed. In such an assumed sale regard can be had to the likely attributes of the hypothetical seller. Thus in *Railtrack plc v Guinness plc* [2003] 1 EGLR 124, which concerned the assumed sale pursuant to compulsory powers of land over a railway, the Court of Appeal upheld the conclusion of this Tribunal that the hypothetical seller would be a company or authority with the function of maintaining the track. In Chapter II lease extension cases, if the hypothetical seller could be expected to have an interest not just in the subject flat but also in the other flats in the block and if it could be expected also that he would only sell his interest in the block as a whole, the proper way to value the ILI, in our judgment, would be as a component of such a sale of the intermediate interest.

54. Even though neither case referred to above was dealing directly with the point in issue in this clear, the language and approach are very

[3]Mr Beckett agreed in cross-examination that the market was buoyant at the valuation date

clear. We are not persuaded that there is anything *Yates* (where there is no real discussion on the issue) or *Hauser* (very specific to the unusual building concerned in that case) to persuade us that the Respondents' approach on this question is correct.

Principled Relatively

55. Again we reject Mr Beckett's (very carefully considered and well argued) position on this point.

56. We were told that the theory has already been considered by a Leasehold Valuation Tribunal and by the Upper Tribunal (by way of consideration of permission to appeal) and rejected and accordingly we are reluctant to disagree with a higher Tribunal's view on the matter.

57. We are not in any event convinced that there is either a need to resort to a purely theoretical approach or that the methodology used in that theoretical approach is entirely sound.

58. It has to be borne in mind that what we are trying to get to is a value for the short lease in a no-Act world. There is no requirement nor any concept for/of Relativity in the Act. Relativity is simply one way to try to arrive at a short lease value or put another way, is simply the result of the difference between a short lease and a long lease value.

59. We are not of the view from the authorities to which we have been referred that either; (a) real market evidence has to be ignored, or; (b) market evidence cannot be used.

60. We consider that there is market evidence in this matter, that being the sales of the two short leases in the subject properties, that can be properly used in the calculation of short lease values.

61. We are concerned that Mr Beckett's figures, derived from his Principled Relativity graph, depend on a starting point of 98% on a lease with 100 years remaining. He takes that 98% as a given on the term of 100 years. That is not necessarily the case. A small movement in the 98% figure either way produces larger and larger variations the further one moves down the graph towards zero years. If there is a significant difference produced down at the 16-year end of the graph by a variation in the 98% and if we are not convinced that 98% for 100 years is correct, then we cannot rely on the graph. It seems to us that if the graph is used, the figure that it produces cannot then be adjusted (because of course Principled Relativity does not admit other evidence or opinion).

62. Turning then to Mr Lester's methodology, he uses a mixture of market evidence (partially adjusted) and relativity graphs. It was submitted on the Applicants' behalf that Mr Lester was too subjective in his calculations and that his relativities for the flats were at the extreme range.

63. We consider that Mr Lester set out a logical basis for his approach. There was no obvious error in this approach. His methodology is widely used and accepted by valuation Surveyors generally. Using his adjusted market figures approach he arrived at Relativities outside the range indicated by the various commonly used graphs. This can be justified by the argument that Relativity figures should in themselves drive the equation; as stated above, Relativity is not a concept that appears in the Act. In any event, he made a final adjustment to his Relativity figures after taking into account the relevant graphs.

64. We accept that for the Raised Ground Floor Flat there is good market evidence as a starting point and we accept that market evidence for the First Floor Flat can be the subject of suitable adjustments.

65. Accordingly we accept Mr Lester's approach to Relativity and his figures.

Discount on the landlord's interest for the risk that vacant possession will not be available

66. We do not consider that there should be any discount in this case for the following reasons:-

(a) Such a discount is not automatic

(b) As the law currently stands, no Assured tenancy can arise at the termination of the lease

(c) There is no imminent risk

(d) An Assured Tenancy at a market rent would not be a disaster for a freeholder

(e) A purchaser, in our view, would not consider the risks of litigation, either by reference to a Rent Assessment Committee to argue about rent or to the County Court to obtain an order for possession, to be significant.

(f) *Clarise Properties Limited* [2010] LRA/170/2010 is not authority for a discount to be applied in every case and the figure of 20% discount applied in that case appears to have no evidential basis.

Conclusion

67. In the circumstances, we will adopt Mr Lester's revised valuations in full.

Mark Martynski, Tribunal Judge
17 July 2014