UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2009] UKUT 235 (LC)
LT Case Number: LRA/97/2008

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – flats – price – deferment rate – whether* Sportelli *starting point to be adjusted to reflect different growth rates and different rates of deterioration and obsolescence in West Midlands and Prime Central London, and increased management burdens with flats – appeal allowed – deferment rate increased from 5% to 6%.

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL OF THE MIDLAND RENT ASSESSMENT PANEL

BETWEEN

(1) MR D ZUCKERMAN
(2) MS S PATEL
(3) MR AND MRS A C COLLINS
(4) MR B NAIR
(5) MR J W HUTTON
(6) MR AND MRS T J CLIVES
(7) MR AND MRS R SONI
(8) MR A J ADAM
(9) DR O'KLEIN
(10) MRS J M GOOD
(11) MR J KAIL **Appellants**

and

TRUSTEES OF THE CALTHORPE ESTATES **Respondent**

Re: Flat 1, 2, 5, 6, 19, 21, 31, 33, 34, 35 and 36 Kelton Court, Carpenter Road, Edgbaston, B15 2 JX

Before: N J Rose FRICS

Sitting at Dudley County Court, Harbour Buildings, Waterfront West, Dudley, West Midlands, DY5 1LN on 22 and 23 September 2009

Douglas Readings, instructed by Hadgkiss Hughes and Beale, solicitors of Acocks Green, for appellants
Anthony Radevsky, instructed by Boodle Hatfield, solicitors of London for respondent

The following cases are referred to in this decision:

Cadogan v Sportelli [2007] 1 EGLR 153
Cadogan v Sportelli [2008] 1 WLR 2142
Re Mansal Securities Ltd and others' appeals [2009] 20 EG104
Daejan Investments Ltd v The Holt (Freehold) Ltd LRA/133/2006 (unreported)
Hildron Finance Ltd v Greenhill (Hampstead) Ltd [2008] 1 EGLR 179
Arbib v Cadogan [2005] 3 EGLR 139
Culley v Daejan Properties Ltd LRA/82/2007 (unreported)

The following additional cases were also cited in argument:

Nicholson v Goff [2007] 1 EGLR 83
Cik v Chavda LRA/111/2007 (unreported)
Culley v Daejan Properties Ltd LRA/82/2007 (unreported)

DECISION

Introduction

1. This is an appeal by the leaseholders against a decision of the Leasehold Valuation Tribunal of the Midland Rent Assessment Panel, determining the premiums payable in respect of the grant of eleven lease extensions pursuant to Chapter II of Part I of the Leasehold Reform, Housing and Urban Development Act 1993. Permission to appeal was granted by the LVT. The properties in question are flats 1, 2, 5, 6, 19, 21, 31, 33, 34, 35 and 36 Kelton Court, Carpenter Road, Edgbaston, B15 2JX. The LVT decided that the premium payable by the leaseholder of flat 33 should be £9,887 and that the premium for each of the other flats should be £9,843.

2. It was agreed at the LVT that the capitalisation rate to be applied to the ground rent was the same as the deferment rate to be applied to the value of the extended lease and the latter was the only point in dispute. The LVT decided that the deferment rate should be 5%, the figure suggested by the freeholder, the Trustees of the Calthorpe Estates. Before me the LVT's decision was supported by the respondent freeholder and the appellants contended for a deferment (and capitalisation) rate of 6.5%, resulting in premiums of £7,569 (£7,594 in the case of flat 33).

3. The appellants are:

Flat No.	Leaseholder(s)
1	Mr D Zuckerman
2	Ms S Patel
5	Mr and Mrs A C Collins
6	Mr B Nair
19	Mr J W Hutton
21	Mr and Mrs T J Clives
31	Mr and Mrs R Soni
33	Mr A J Adam
34	Dr O'Klein
35	Mrs J M Good
36	Mr J Kail

4. Mr Douglas Readings of counsel appeared for the appellants and called expert evidence from E J Rutledge FRICS, a partner in Messrs Lawrence and Wightman, chartered valuation and building surveyors of Birmingham. Counsel for the respondent, Mr Anthony Radevsky, called Mr J K Willson BSc, MRICS, a consultant to the Birmingham office of Lambert Smith Hampton, as his expert witness. I inspected the appeal properties, accompanied by representatives of the parties, on the afternoon of the second day of the hearing.

5. I was told that there are outstanding appeals to this Tribunal in respect of approximately 20 other flats in Edgbaston, which have been stayed pending the decision on this appeal.

Facts

6. In the light of the evidence and my inspection I find the following facts. The appeal properties are on the Calthorpe Estate, comprising appropriately 1,500 acres in Edgbaston and Harborne, Birmingham. At its nearest point the estate is about 1.2 km from the centre of Birmingham. It contains about 7,000 properties, including offices, shops, hotels, leisure and recreational uses as well as residential properties. There are some 2,000 flats on the estate, most of which are purpose built. A Scheme of Management to which all freehold properties are subject was granted to the respondent in 1974, pursuant to section 19 of the Leasehold Reform Act 1967.

7. The appeal properties are located within the Edgbaston conservation area, in an established residential area on the south side of Carpenter Road at the junction with Church Road. The Kelton Court development comprises 36 purpose built flats, erected in the 1970s and located in six three-storey blocks. The accommodation in each flat comprises an entrance hall, one double bedroom, one single bedroom, living/dining room, kitchen, bathroom and separate wc. Each of the appeal properties includes a single garage in a separate block.

8. Each flat is held on an underlease for a term expiring on 26 September 2071 at current ground rents of £75 per annum, increasing to £100 in September 2022 and £125 in September 2047. The landlord is responsible for insuring the premises and recovers the appropriate premium from each lessee as part of the service charge. The landlord's responsibilities include maintenance of the structure and the common areas of the flats and garages, the private roads and amenity areas. The lessees contribute to a service charge to meet the cost of these items. The use of each flat is restricted to that of a private residence of a single family only, such family to comprise not more than four persons.

9. It is agreed that, for the purposes of valuing all the flats except No.33, the unexpired lease term is 64 years. The notice of claim for flat 33 was served on 28 January 2008, when there were approximately 63.75 years unexpired. The head lease was surrendered on 19 May 1981, since when the appellants have held their properties directly from the respondent.

Evidence

10. Mr Rutledge has worked in Birmingham and the West Midlands for approximately 30 years and is regularly involved in inspections and valuations of a broad range of residential, commercial and industrial properties. He is currently increasingly involved in leasehold reform work in London, Hertfordshire and other regions in England and Wales. Mr Rutledge said that in *Cadogan v Sportelli* [2007] 1 EGLR 153 the Lands Tribunal (George Bartlett QC, President, HH Michael Rich QC and P R Francis FRICS) had determined the deferment rate for flats in Prime Central London (PCL) at 5 per cent. This was arrived at as follows: risk free rate (2¼%), minus real growth rate (2%), plus risk premium (4½%), plus increased management risk for flats (¼%). He considered that two matters were relevant when considering the appropriate risk premium for Birmingham, namely obsolescence/deterioration, and long term prospects of capital growth. When considering the potential for

obsolescence/deterioration, the relationship between capital value and the cost of maintenance, repairs and refurbishment should be taken into account. He produced photographs of several of the properties which were considered in *Sportelli*. He said that the majority were within a conservation area, with very significantly higher market values than Kelton Court. He also produced statistical information which suggested that, in 2007, building costs in London were 21.87% higher than in the West Midlands. The capital values of flats in PCL were much greater than the values of flats in Kelton Court. On the other hand, the difference in the cost of maintaining buildings in the two areas was small.

11. It would therefore remain cost effective to rebuild, repair or refurbish high value PCL properties for an almost infinitely longer period than flats such as those at Kelton Court. Kelton Court itself was a development on the site of the old Royal Institution for the Blind. This was just one example of the cycle of redevelopment of old properties in the area. Such redevelopment was common throughout Birmingham and indeed in most parts of the country outside PCL. Other examples were a number of properties on Hagley Road on the Calthorpe Estate, which had been derelict and awaiting redevelopment for several years, and a 1960s development of flats at Montague Road, Edgbaston, just outside the Calthorpe Estate but only about a mile from Kelton Court, where the state of deterioration was very marked. These were good examples of what happened when the cost of building works and repair was very high compared to the market value of the existing properties.

12. Turning to changes in property values, Mr Rutledge said that he had tried to find reliable, long term statistics relating to PCL and Birmingham or the West Midlands. It was difficult to find information and statistics split into localities going back 40 or 50 years, which would be the ideal. He had researched information available from the Nationwide Building Society, HBOS (previously the Halifax Building Society), the Land Registry, the Valuation Office Agency and others.

13. He produced a graph, incorporating house price information obtained from various published statistics, together with the available information on sale prices in Kelton Court. He said that this graph demonstrated a significant difference in property prices between Kensington and Chelsea (in Prime Central London) and the West Midlands and the UK as a whole and Kelton Court in particular. It also showed a very significant difference in the rate of growth in the value of properties in these areas. The trend in Kelton Court was a little below that of both the West Midlands and the UK national average in the periods plotted.

14. Mr Rutledge also compared the attributes of investments in flats and houses. He said that the liquidity of the freehold interest in any flats development had always been lower and more of a problem than the equivalent freehold investment in houses. The right of first refusal granted by the Landlord and Tenant Act 1987 had been in place for over 20 years and those procedural requirements had had a clear effect on the ability of any freehold investor to deal freely with his assets.

15. In addition, the gradual introduction of the various sections of the Commonhold and Leasehold Reform Act 2002 (the 2002 Act) had placed more significant management burdens on investors in flats and maisonettes. The need to consult lessees on qualifying long term

agreements, administration charges and major expenditure had increased the risk that landlords could be tripped up and challenged. Freeholders then faced the real prospect of having to pay for certain significant items of expenditure without any chance of recovering the cost from lessees. Such legislation applied equally to property in PCL and to Kelton Court, but Mr Rutledge believed that it was a material factor which would widen the gap between the yields for houses compared to flats and maisonettes. In short, he felt that the quarter per cent difference arrived at in *Sportelli* no longer realistically reflected the differences between the two forms of investment.

16. The number of cases brought before LVTs in connection with disputed service charges, and in particular the consultation requirements contained in section 20 of the Landlord and Tenant Act 1985 (as amended by the 2002 Act), were very significant. He produced statistics obtained from the Residential Property Tribunal Service website which showed that, in 2007, there were 411 service charge disputes in London, almost all of which related to flats and maisonettes. This compared with 232 cases in 2005 and 27 in 2004.

17. In Mr Rutledge's opinion, there should be added to the 5% starting point for flats adopted in *Sportelli*, between 0.5% and 0.75% for the higher rate of obsolescence/deterioration at Kelton Court compared to PCL; between 0.5% and 1.0% to reflect investors' concern as to whether the growth rate in capital values would be as high in Birmingham as in PCL, and 0.25% to reflect the increased gap between houses and flats resulting from recent legislative changes. Cumulatively this produced a minimum deferment rate of 6.25% and a maximum of 7%. In his view the appropriate rate for the appeal properties should be 6.5%. This assessment did not include a specific allowance for increased volatility. In the course of his evidence in chief Mr Rutledge said that, although he had suggested at the LVT hearing that volatility was greater in the West Midlands than in PCL, on reflection he no longer considered that to be the case. In cross examination he accepted that this change of opinion should be reflected by reducing the deferment rate from 6.5% to 6.25%.

18. Between 1984 and 1997 Mr Willson was employed by the respondent, dealing with a range of commercial and residential estate management matters, including responsibility for all freehold sales. He worked as a surveyor in the Birmingham office of Lambert Smith Hampton between February 1998 and February 1999, dealing with a variety of professional work and property management, including Leasehold Reform Act work and sales on a voluntary basis. In his present position he specialises in leasehold enfranchisement work and voluntary sales of freeholds and grants of extended leases. Mr Willson has personally dealt with around 250 lease extensions under the 1993 Act and over 1,000 claims under the 1967 Act. He considered that the expectations of future growth were reflected in current capital values. He disagreed with Mr Rutledge's view that property values in the West Midlands had grown at a slower rate than in PCL. He said that there were now many indices that attempted to measure changes in the housing market. Some sought to track national or regional trends and others considered different types of residential property. The compilation of such indices involved complex sampling and mathematical modelling. There were considerable variations between indices. An individual index would mask major differences in changes in prices between property types and locations.

19. The difficulties of using indices were illustrated in the average prices data compiled by the Department for Communities and Local Government and National Statistics. This data was broken down by property type, including purpose built flats. The data was, however, compiled by region and presumably included a very diverse range of properties, both type and location. Two separate tables were compiled, with some variation in the make up of the regions and different start dates. The first table showed the changes in average prices for purpose built flats in different parts of the UK between 1983 and 2007. The second showed the corresponding changes between 1986 and 2007. Although there were differences between the extent of some of the regions in the two tables, the extent of the London and the West Midlands regions was the same in both. The standard West Midlands economic region included Herefordshire, Shropshire, Staffordshire, Warwickshire and Worcestershire, plus the metropolitan districts making up the old West Midlands county. The region was therefore both large and very diverse. The only difference between the two sets of data, as far as London and the West Midlands were concerned, was the start date. Table 1 showed growth in London that was higher than any other region in the UK and higher than any of the other eight regions. In table 2, with a start date three years later, the growth rate in London was very close to that in the country as a whole, whereas growth in the West Midlands was higher than in London. This showed how a relatively small difference in the period for which data had been compiled could lead to a radically different result.

20. The two tables did not show real growth. In order to strip out the effects of inflation Mr Willson deducted the inflation rate, based on the retail price index, from the annual growth rate for the West Midlands and London. Between 1983 and 2007, the average real growth rate was 6.43% per annum for London and 5.88% per annum for the West Midlands. Between 1986 and 2007 the figures were 5.49% and 6.16% respectively. For both areas, over these periods, the average level of real growth was significantly greater than 2%.

21. Any attempt to use indices to determine rates of growth in different areas presented considerable difficulties. Such evidence as was available did not generally establish any sustained differences in growth rates over the long term. Moreover, such indices only showed past performance. Although they might assist a potential investor in deciding the likely rate of future growth, it was far from certain that they would be a decisive influence on the price he would be prepared to pay for the reversion.

22. Mr Willson did not agree with Mr Rutledge's view that obsolescence and deterioration would be greater at Kelton Court than in properties in the PCL. He said that repair and obsolescence should not be confused. Parts of buildings broke or wore out over time and needed to be repaired or replaced. Other parts needed regular maintenance. In most purpose built flats, including Kelton Court, the landlord was responsible for external and structural repairs, but recovered these costs from the tenants via a service charge. When the leases expired the building should be handed back in repair. Obsolescence was considered in detail by the Tribunal in *Daejan Investments Ltd v The Holt (Freehold) Ltd* (LRA/133/2006, unreported). Here a building that was "tired and shabby" (para 85) was not considered to be at greater risk of obsolescence than the norm.

23. Mr Willson considered that the relatively high level of repair costs in London was significant. Moreover, costs in the PCL area were probably higher than in London postal districts generally. Buildings were often taller than in the West Midlands. Four, five and six storey buildings, especially where the site coverage was extensive and the buildings close to the highway, meant that access for building works was difficult, with potentially significant cost consequences. A much higher proportion of flats in the PCL area were in buildings converted to use as flats and this could result in higher maintenance costs.

24. The state of repair did not determine whether a building was obsolete. Obsolescence had more to do with function than condition. A building became obsolete, either because it no longer met the requirements for which it was built, or because it no longer met the needs of occupiers, or because the use for which it was designed no longer existed, or was no longer appropriate. Nearly all buildings, even new ones, had a degree of obsolescence. Many houses in the PCL area, for example, were built before the era of almost universal car ownership and had no parking spaces and nowhere to create one. They therefore had a degree of obsolescence, which could normally not be remedied without redevelopment. As a result, properties with off-street parking usually sold for higher prices than comparable properties without parking. The degree of obsolescence, in this case, was reflected in the vacant possession value of the property. Mr Willson considered that that was the correct approach.

25. The extensive redevelopment of properties in Birmingham, and particularly on the Calthorpe Estate, had to be viewed in its historical context. In the immediate post-war period the estate trustees were under considerable pressure to increase the density of development on their land. There was a fear that otherwise large areas of the estate could be compulsorily purchased by the local authority for redevelopment. It was therefore decided to instruct a local architect to prepare a plan for the redevelopment of three residential sectors within the estate. This was published in 1958 and was designed to raise the density of the estate to 30 persons to the acre by 2000. It would have been possible to achieve this by clearing large areas and building traditional suburban houses at 8 to 10 to the acre. It was, however, decided to consider the characteristics of individual sites and preserve landscape features, trees and boundary walls. Various sites were developed with a mixture of high and low rise flats, town houses and traditional low density housing. The Ampton Green Development, of which Kelton Court forms part, comprises 36 houses and 36 flats. There are relatively large four bedroom detached houses at a low density, with the flats serving to increase the overall density. Whether the redeveloped buildings had all been truly obsolete was not a major factor leading to their redevelopment.

26. Paradoxically, many properties that would have been thought to be obsolete in the past had been retained. When Kelton Court was built, many older houses in the area were converted to flats, bedsits and hostels. Most had now been restored to single family use. Although not expensive by the standards of some parts of the PCL area, some of the most valuable houses in the West Midlands were close to Kelton Court. Moreover, Kelton Court was now within a conservation area and there were therefore greater planning restrictions on redevelopment.

27. The nature of property was such that it would deteriorate over time. Provided leases were adequate to ensure suitable standards of repair this should be mitigated. Both building quality and design had an impact upon the speed with which a building became obsolete and would potentially have an effect on condition. Factors such as type and quality of construction, however, were reflected in the vacant possession value of the property. This approach had been endorsed by the Lands Tribunal in *Sportelli*.

28. Mr Willson then considered the distinction between the treatment of houses and flats. In *Arbib v Cadogan* [2005] 3 EGLR 139 the Tribunal concluded that there should be a general addition to the deferment rate to reflect the differences between the two classes of property. This was largely because of a perceived difference in management requirements. However, provided leases were properly drafted, were comprehensive in their requirements and allowed for the full recovery of management costs, the actual cost to the landlord of a block of flats should be no greater than for any other property investment. All residential property had been subject to increased statutory intervention in the relationship between landlord and tenant over the years. Changes to consultation requirements were introduced by the 2002 Act and came into force prior to the decision in *Sportelli.* The requirement for consultation applied to houses as well as flats. Mr Willson did not consider there was any reason why the impact in Birmingham should be different from that in PCL. There was probably some justification for an addition for flats, but this should not exceed the figure of 0.25% adopted in both *Arbib* and *Sportelli*.

29. In Mr Willson's opinion, the length of the lease and the extent of the landlord's management obligations could influence the value of the landlord's reversion and lead to an adjustment to the deferment rate. Matters such as expectations of future growth, location, obsolescence and condition, however, would influence the value of all interests in the property, not just the freehold reversion. Mr Willson considered that such factors were already reflected in the vacant possession value. Only in the most exceptional cases would they justify a change in the deferment rate.

30. In a supplementary report issued in the light of comments made in para 33 of my decision in *Re Mansal Securities Ltd* and others' appeals [2009] 20 EG 104, Mr Willson made the following additional points. He was not aware of any general evidence to suggest that there were widespread problems in recovering service charge contributions. It did not follow from the fact that people lived in high value properties that they had substantial incomes from which to meet repair costs. Pensioners, for example, might be "asset rich" but still have modest disposable incomes. A number of factors needed to be borne in mind when attempting to use house price data to assess variations in growth rates. In *Hildron Finance Ltd v Greenhill (Hampstead) Ltd* [2008] 1EGLR 179, the Tribunal (HH Judge Reid QC and N J Rose FRICS) suggested that periods in the region of 50 years, with different starting dates, should be looked at in order to obtain a reliable indication of the long term movement in residential values. This analysis could not be undertaken in practice. The Nationwide UK House Price Index was the only one which covered a 50 year period and this looked only at the national picture. In the 1970s the Nationwide and the Halifax started to produce indices, showing changes in house prices on a regional basis. They used the standard West Midlands economic region, used regularly in the production of economic statistics. It covered an area of 12,998 sq km (5,019 sq miles), ranging from Stoke-on-Trent in the north to Hereford in the south and from the Welsh

border to Rugby. It contained a wide range of properties in many very different locations. There was therefore likely to be considerable variation, at least in the short term, in the rate of change in prices within the region. Local factors were likely to be masked by the wider regional picture. A number of indices had recently been compiled at a more local level, usually based on local authority areas. Even at this level variations could be hidden, particularly in large local authority areas like Birmingham. Moreover, most of these indices only went back to 2000, when HM Land Registry started to make sale prices available. Ideally, long term data would be available for local areas. Even this would create problems, since if the pool of data was too small, individual transactions started to skew the results.

31. Mr Willson drew attention to the fact that the way the Nationwide UK House Price Index was calculated had been changed four times. It was not clear whether this made any difference, but it highlighted the difficulties of using such data, particularly for non-statisticians. The Lands Tribunal had expressed a desire to see a comparison of different indices over different periods. It was difficult to make that comparison, even when the indices existed, because it was not clear how they had been compiled and what data had been used. The Nationwide and Halifax West Midlands indices showed very different rates of change for the same region and property types.

32. Mr Willson concluded that all these factors tended to undermine the usefulness of such statistical information. At best, they presented an unreliable picture of the past and were not a useful guide to future performance.

33. Dealing with Mr Rutledge's reference to changes in legislation, Mr Willson said that the Residential Property Tribunal Service website indicated that there had been only six service charge disputes in Birmingham in 2007. Given that Birmingham was significantly larger than any of the London boroughs, this did not suggest that the problem was more serious in Birmingham.

34. In his supplementary report Mr Rutledge said that he had spent much time seeking an experienced expert witness who might be willing to give further evidence before the Tribunal in relation to the PCL investment market. In preliminary informal conversations with senior partners/directors of many of the largest firms in the country, it was clear that they shared his general view that the property investment market in PCL was unlike that in any other part of the country. However, in every case the individual concerned had been unable or unwilling to appear before the Tribunal because of conflicts of interest with clients owning properties outside London.

35. Mr Rutledge said that he had made further extensive enquiries to discover whether there were other relevant sources of statistical information. He had obtained clarification from the compilers of the Nationwide and Halifax statistics of the different methodologies employed. It was clear from his enquiries of one of Nationwide's senior analysts that, contrary to the suggestion in *Mansal*, the Nationwide did not include studio flats at all in their calculations. Their main regional indices were weighted according to transactions in each area and covered all properties, subject to their "cleansing" criteria used to strip out unusual cases. This system of weighting allowed them to adjust the mix of properties in the sample in each quarter, with

weights being updated periodically to reflect changes in the types of property sold. This process ensured that the series was adjusted to remove any inconsistencies. The purpose of these adjustments was to achieve a consistent series which could be used for long run analysis. Mr Rutledge also produced a copy of the Halifax House Price Index technical details and background. Halifax, too, used methods of standardisation and disaggregation of prices into their constituent parts, to enable them to track the value of a typical property over time on a like for like basis (ie with the same characteristics). The Halifax database started in 1983. Their technical details section emphasised that the size of the database was exceptionally large because of the number of transactions financed by the Halifax each month, and because the scope of their data collection was more extensive than anything hitherto available in the UK.

36. Although Mr Rutledge was not an expert statistician, he felt that the striking feature of the statistics summarised in his first expert report and as illustrated in his comparative property price graph was that in the long term both the Halifax and Nationwide tables produced remarkably similar statistics. A comparison of the Nationwide regional table from 1973 for the West Midlands and the Halifax West Midlands table for all properties from 1983 showed little variance.

37. Mr Rutledge pointed out that the LVT had found that "the growth rate in PCL probably has exceeded that in the West Midlands". Any investor would be interested in the prospects for growth, as well as the security of the investment and the anticipated income. His professional experience led him to conclude that an investor would not pay the same price for a property in the West Midlands as for one in PCL, which was demonstrably likely to appreciate at a greater rate in the long term. On the balance of probabilities, therefore, he would have to advise an investor that an investment in PCL would always, in the long term, be expected to produce more growth than a comparable investment in the West Midlands and this would be reflected in the level of the investor's bid.

38. Mr Rutledge said that he had given further careful thought to the comments of the Tribunal in *Hildron* and in particular in paragraph 39. He did not know why a 50 year period had been highlighted as particularly important when looking at statistics for movements in property prices. There was no comprehensive set of figures or statistics for property prices going back 50 years from the valuation date to 1958 except for the Nationwide UK House Price Index. That overall UK index started in 1952 and there did not appear to be anything else which distinguished between PCL and the West Midlands going back that far.

39. Looking at the available information, whether one started with figures in 1952 or any other date over that decade, the conclusion was very much the same. The first point at which different figures were available for London as compared to other parts of the country appeared to be in about 1973, when the Nationwide Regional Table was created. A noticeable divergence between that and other parts of the country opened up from that date gradually but inexorably, as could be seen from the comparative property price graph.

Conclusions

40. *Sportelli* was concerned with residential properties in PCL. As Carnwath LJ pointed out in the course of his judgment in the appeal, [2008] 1 WLR 2142 at para 102:

> "The issues within the PCL were fully examined in a fully contested dispute between directly interested parties. The same cannot be said in respect of other areas. The judgment that the same deferment rate should apply outside the PCL area was made, and could only be made, on the evidence then available. 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. The deferment rate adopted by the tribunal will no doubt be the starting point; and their conclusions on the methodology, including the limitations of market evidence, are likely to remain valid. However, it is possible to envisage other evidence being called, for example, on issues relevant to the risk premium for residential property in different areas. That will be a matter for those advising future parties, and for the tribunals, to consider as such issues arise."

41. Thus the starting point when considering the appropriate deferment rate to be adopted in this appeal is the 5% determined in *Sportelli* for flats in PCL. This rate was arrived at as follows:

Risk free rate	2.25%, minus
Real growth rate	2.00%, plus
Risk premium	4.5%, plus
Increased management risks for flats	0.25%

42. In its decision dated 7 September 2009 in *Culley v Daejan Properties Ltd* (LRA/82/2007, unreported) the Tribunal was required to determine the appropriate deferment rate for a block of flats in Eastcote, Middlesex. The Members (George Bartlett QC, President and P R Francis FRICS) quoted the remarks of Carnwath LJ at paragraph 102. They continued:

> "35. Thus evidence of valuers as to whether a higher risk premium should be taken because of the features of the property under consideration, including its location, is of undoubted relevance, and if a tribunal is satisfied on the evidence before it that such features justify the application of a higher deferment rate then, of course, it ought to apply such higher rate. In determining whether a higher rate is appropriate it will need to bear in mind the considerations that led the Tribunal in *Sportelli* to adopt the approach that it did, and the primary question will always be whether there are particular features that are not fully reflected in the vacant possession value and thus should be reflected in a higher risk premium. Moreover – and this is a matter that may not, or may not sufficiently, emerge from the Tribunal's post-*Sportelli* decisions – what matters is the view that the market, properly informed on relevant factual matters, would take on such features (the prospective movement of house prices in the area, for instance, or the potential obsolescence of the property) in considering an investment in the reversion. On this the expert opinion of the valuer is likely to be important."

43. Mr Willson considered that there was no justification for a departure from any of the *Sportelli* elements of the deferment rate when valuing a block of flats such as Kelton Court, located in Edgbaston in the West Midlands. Mr Rutledge, on the other hand, was of the view that the risk premium should be increased to reflect a greater risk of deterioration and obsolescence and the risk that the real growth rate of 2% per annum assumed in *Sportelli* would not be achieved in Edgbaston over the long term. He also thought that *Sportelli*'s one quarter per cent addition for management was now insufficient, in view of the increased market awareness of the financial risk to landlords of flats, resulting from the coming into effect of various sections of the 2002 Act. My conclusions on each of these factors follow.

Deterioration and obsolescence – conclusions

44. In Mr Rutledge's opinion, by comparison with the much more valuable properties in PCL, there was a greater risk that flats in Edgbaston would become obsolete over the term of the existing leases, or that the extent of deterioration would be so great that the flats would no longer be worth repairing. Mr Willson disagreed. He said that it was inevitable that parts of buildings would need to be repaired or replaced over time and other parts would need regular maintenance. In most purpose-built blocks of flats, including Kelton Court, the buildings should be handed back in repair when the leases expired. As for obsolescence, Mr Willson said that this was a factor which was common to most buildings. As in the case of the "tired and shabby" building considered by the Tribunal in *The Holt*, Kelton Court was no more at risk of obsolescence than the norm.

45. In *Sportelli*, the Tribunal's conclusion on obsolescence and condition was set out in para 91 in these terms:

> "As with location, while we do not rule out the possible need to adjust the deferment rate to take account of such matters as obsolescence and condition, we think that it would only exceptionally be the case that such factors 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."

46. Mr Rutledge produced a schedule showing that the values of the properties considered in *Sportelli* were of a different order of magnitude from those of the flats in Kelton Court. Of the six PCL buildings considered in *Sportelli*, the LVT decisions provided the necessary information to enable the value per square foot of four to be calculated. These values ranged from £740 to £1,100 per sq ft. and the relevant valuation dates were between December 2003 and July 2005. By contrast, the value of Kelton Court as at September/October 2007 was only £198.50 per sq ft. I do not consider that the fact that there has been extensive redevelopment in Birmingham proves that the previously existing buildings had become obsolete. Nor does the fact that most of the *Sportelli* properties are in a conservation area mean that they cannot become obsolete. Nevertheless, as Mr Rutledge observed, the difference between the value of flats in Kelton Court and those considered in *Sportelli* is striking. Although building costs were somewhat higher in London than in Edgbaston, I accept Mr Rutledge's opinion that it is likely to remain economically viable to repair high value properties in PCL for considerably longer than it will for similar sized flats in Kelton Court. As a result, whilst the individual flats might be leased on full repairing terms, there is a greater risk of deterioration at Kelton Court

than in PCL properties, but this is not reflected in the respective vacant possession values. I find that a purchaser of the freehold reversion to Kelton Court would have required an increase of 0.25% in the risk premium to 4.75% to compensate for this difference.

Prospect of future growth – conclusions

47. Mr Rutledge produced statistical evidence which, he said, demonstrated why a potential purchaser of a reversion secured on Kelton Court would be concerned that the long-term growth rate of 2% adopted by the Lands Tribunal in *Sportelli* might not be achieved. Mr Willson disagreed, on the basis that the deficiencies in the available statistics meant that it was difficult to draw reliable conclusions from them about long-term growth rates in the past and that, even if these difficulties could be overcome, historic information would not provide a useful guide to future performance.

48. In *Hildron* the Tribunal said at para 39:

> "In order to provide a reliable indication of the long term movement in residential values so as to justify a departure form the *Sportelli* starting point, we consider that a period in the region of 50 years should be looked at, and that a series of statistics with different starting dates should be considered in order to ensure that an unrepresentative period is not relied upon."

49. Both experts in the present case have taken trouble to search for all the available statistics illustrating residential property movements in the West Midlands and the PCL over the past 50 years. As a result, it appears that the statistical information that the Tribunal indicated in *Hildron* would be required is simply not available. Contrary to the impression which I obtained in *Mansal,* the Nationwide statistics do not provide a reliable indication of the relative change in house prices in the West Midlands and Inner London between 1952 and 2007. Nationwide did not provide separate statistics for the West Midlands until 1973. The information referred to in para 30 of *Mansal* was based on an attempt by a surveyor giving evidence at an earlier LVT hearing to extrapolate back from statistics relating to the West Midlands rather than using actual base data.

50. Despite their deficiencies, the patterns of price movements shown in the Nationwide Regional Index – West Midlands for all residential properties from the fourth quarter of 1973 and the corresponding Halifax Regional Index from the first quarter of 1983 are similar. The trend of increase illustrated by both indices – and also by the history of price increases in Kelton Court – is significantly slower than that shown by the Knight Frank Index for Kensington and Chelsea (part of PCL) since 1976. Notwithstanding the statistical evidence to which he refered in his written report (see para 20 above), Mr Willson accepted in cross-examination that information similar to that shown on Mr Rutledge's graph would have been provided to an investor, seeking to compare the likely growth rates of residential properties in the West Midlands and PCL. In his view the graph showed that, over the periods covered by the available statistics, London had a slight advantage, but

> "we do not know whether they show the long-term position. All you can do is give the available information to the investor and he has to take the decision [on which location offers better growth prospects] which cannot be based on hard evidence."

51. In my judgment, in spite of its undoubted limitations, the available statistical information demonstrates that the difference between past rates of long-term price increases in PCL and in the West Midlands has been not slight but considerable. I accept Mr Rutledge's opinion that this information would persuade an investor that he could reasonably anticipate significantly slower long-term growth from residential properties in the West Midlands generally than in PCL and I find that there was no reason to suppose that the position would be significantly different in the case of Kelton Court itself.

52. In arriving at its conclusion, in para 72 of *Sportelli*, that a real growth rate of 2% per annum should be assumed in calculating the deferment rate, the Tribunal said

> "we think a realistic, or neutral, assumption would be 2%, the one made by Mr Cullum, with any concern on the part of the investor that this rate might not be achieved being reflected in the risk premium."

53. As I have said, the 5% deferment rate determined in *Sportelli* for flats in PCL is the starting point for calculating the appropriate rate for Kelton Court. Since, as I have found, an investor considering long term growth prospects at Kelton Court would not be confident that the PCL growth rate would be achieved (or, put another way, would be less confident that the real growth rate of 2% would be achieved in the West Midlands than in PCL), he would reduce his bid for Kelton Court accordingly. The appropriate way to assess that reduction, in my view, is by further increasing the risk premium by 0.5% to 5.25%.

Allowance for flats

54. In *Sportelli*, the Tribunal's conclusions on the difference between the deferment rate for houses and flats were contained in para 95 as follows:

> "We think, however, that an adjustment needs to be made to reflect the greater management problems [associated with flats], although we do not consider it appropriate to differentiate between flats that are the subject of headleases and those which are not. Nor do we think that the management concerns are necessarily so much less for a single flat than for a block to warrant a different adjustment. Even where flats are efficiently managed, service charge and repairs problems inevitably occur, and the management exercise in itself is, we feel, sufficiently more complex to warrant a generalised 0.25% additions for flats. We do not consider that any fine-tuning below this percentage is justified."

55. Mr Rutledge relied primarily on the introduction of the provisions of the 2002 Act to support his view that the risks to landlords of flats had increased since *Sportelli*. He had in mind in particular The Service Charges (Consultation Requirements) (England) Regulations 2003 (the 2003 Regulations), which imposed strict procedural requirements, failure to comply

with which could leave landlords unable to recover a large proportion of the costs of repairs. Although these regulations had come into force nearly three years before the *Sportelli* hearing, the potential seriousness of their impact had become increasingly widely known and this had reduced the relative attraction of investments secured on blocks of flats. Mr Willson replied that there had not been any changes to legislation post-*Sportelli* that would have made a difference. There was no reason why the impact in Birmingham should be different from PCL.

56. The provisions of the 2003 Regulations are potentially extremely serious for landlords (see the Lands Tribunal decision dated 11 April 2008 (George Bartlett QC, President and N J Rose FRICS) in *London Borough of Camden and The Leaseholders of 37 flats at 30-40 Grafton Way*, (LRX/185/2006, unreported). I accept Mr Rutledge's evidence that, although LVTs have only heard a limited number of service charge appeals relating to properties in Birmingham, there have been other examples of landlords of such properties agreeing to bear part of the cost of disputed items without the need for a tribunal hearing. The 2003 Regulations came into force on 31 October 2003. I am satisfied that by September 2007, the first date with which I am currently concerned, the market was more aware of the dangers posed by the regulations than was the case in *Sportelli*, where the properties fell to be valued between 2¼ and 3¾ years earlier. I conclude that, in the eleven cases with which I am currently concerned, investors would have required an addition of 0.5% to reflect the greater management problems associated with flats than with houses. In reaching this conclusion, I have borne in mind that the subject flats are no longer subject to the original headlease. Had that headlease still been in existence, I would not have considered it appropriate to depart from the *Sportelli* uplift of 0.25%.

Summary

57. The LVT reached the conclusion, based on the evidence before it, that the appellants had not made out their case for a departure from the *Sportelli* starting point of a 5% deferment rate. In the light of the more extensive evidence produced before this Tribunal, I have concluded that the risk premium of 4.5% determined in Sportelli should be increased to 5.25% and that the 0.25% management allowance for flats should be increased to 0.5%, resulting in a deferment rate of 6%. The appeal is allowed. The premium payable by the leaseholder of flat 33 is £8,150. The premium payable by the respective leaseholder or leaseholders of each of the remaining ten flats is £8,100. The calculations producing these figures appear in the Appendix to this decision.

58. I would add that my conclusion in this appeal differs from the one reached by the Tribunal in *Culley*, namely that there was no justification for a departure from the *Sportelli* starting point. In *Culley*, as in the present appeal, the basis of the Tribunal's decision was the expert valuation evidence adduced by the parties.

59. The Tribunal's power to order the payment of costs is extremely limited in cases of this nature. I make no order as to costs.

Dated: 18 November 2009

N J Rose FRICS

Appendix

Flats 1,2,5,6,19,21,31,33,34,35 and 36 Kelton Court
Carpenter Road, Edgbaston, Birmingham

Valuation by Lands Tribunal

All properties except Flat 33

(i) Diminution in the freeholder's interest

Term:

Current rent: £75.00 per year	
Years Purchase: 15 years @ 6% = 9.712	
£75.00 x 9.712 = £728.40	£728.40
Rent (from 2022): £100.00 per year	
Years Purchase: 25 years @ 6% @ 12.783	
PV £1 in 15 years @ 6% = 0.417	
£100.00 x 12.783 x 0.417 = £533.05	£533.05
Rent (from 2047): £125.00 per year	
Years Purchase: 24 years @ 6% = 12.550	
PV £1 in 40 years @ 6% = 0.097	
£125.00 x 12.550 x 0.097 = £152.17	£152.17
	£1,413.62

Reversion:

Open market value with extended lease: £158,025 (excluding tenant's improvements)	
PV £1 in 64 years @ 6%: 0.024	
£158,025 x 0.024 = £3,792.60	£3,792.60
	£5,206.22

(ii) Marriage value

Open market value with extended lease: (excluding tenant's improvements)	£158,025.00
Less Freehold interest	5,206.22
Leasehold interest	£147,000.00
	£5,818.78

(iii) Premium payable

Freehold interest:	£5,206.22
Marriage value (£5,818.78) x 50% =	£2,909.39
	£8,115.61
	Say £8,100

Flat 33

(i) Diminution in the freeholder's interest

Term:

Current rent: £75.00 per year	
Years Purchase: 14.75 years @ 6% = 9.608	
£75.00 x 9.608 = £720.60	£720.60
Rent (from 2022): £100.00 per year	
Years Purchase: 25 years @ 6% = 12.783	
PV £1 in 14.75 years @ 6% = 0.423	
£100.00 x 12.783 x0.423 = £540.72	£540.72
Rent (from 2047): £125.00 per year	
Years Purchase: 24 years @ 6% = 12.550	
PV £1 in 39.75 years @ 6% =0.098	
£125.00 x 12.550 x 0.098 = £153.74	£153.74
	£1,415.06

Reversion:

Open market value with extended lease: £158,025	
(excluding tenant's improvements)	
PV £1 in 63.75 years @ 6%: 0.0244	
£158,025 x 0.0244 = £3,855.81	£3,855.81
	£5,270.87

(ii) Marriage value

Open market value with extended lease:	£158,025.00
(excluding tenant's improvement)	
Less Freehold interest	£5,270.87
Leasehold interest	£147,000.00
	£5,754.13

(iii) Premium payable

Freehold interest:	£5,270.87
Marriage value (£5,754.13) x 50% =	£2,877.07
	£8,147.94
	Say £8,150