

IN THE UPPER TRIBUNAL (LANDS CHAMBER)



Neutral Citation Number: [2017] UKUT 233 (LC)

Case No: LRA/130/2016

LRA 131/2016

LRA/132/2016

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – house – premium – whether three detached houses in Solihull had same growth rate as property in prime central London and should be valued using the Sportelli deferment rate without adjustment for greater risk of lower growth – whether adjustment to the deferment rate justified for obsolescence, volatility and/or illiquidity – section 9(1) Leasehold Reform Act 1967 – appeal allowed

**IN THE MATTER OF THREE APPEALS AGAINST DECISIONS OF THE
FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)**

BETWEEN:

JGS PROPERTIES LIMITED

Appellant

-and-

**(1) MRS S E KING (LRA/130/2016)
(2) MS MONO SEDRO (LRA/131/2016)
(3) MR & MRS NUNNINGTON (LRA/132/2016)**

Respondents

**Re: (1) 206 Damson Lane,
Solihull,
West Midlands,
B92 9JZ**

**(2) 82 Stanbrook Road
Shirley
Solihull
West Midlands
B90 4US**

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**(3) 5 Welham Croft,
Shirley,
Solihull,
West Midlands,
B90 4UU**

Determination on written representations

The following cases are referred to in this decision:

Re Sinclair Gardens Investments (Kensington) Limited's Appeal [2014] UKUT 79 (LC)

Zuckerman v Trustees of the Calthorpe Estate [2009] UKUT 235 (LC)

Re Clarise Properties Limited's Appeal [2012] UKUT 4 (LC)

Re Mansal Securities Limited's Appeal [2009] 2 EGLR 87

The Trustees of the Sloane Stanley Estate v Mundy [2016] UKUT 223 (LC)

DECISION

Introduction

1. On 3 August 2016 the First-tier Tribunal (Property Chamber) (the “FTT”) determined the prices payable by the respondents for the acquisition of the freehold interests in three detached houses at 206 Damson Lane, Solihull, West Midlands B92 9JZ (Mrs S E King); 82 Stanbrook Road, Shirley, Solihull, West Midlands B90 4US (Ms Mona Sedro); and 5 Welham Croft, Shirley, Solihull, West Midlands B90 4UU (Mrs and Mrs Nunnington) pursuant to section 9(1) of the Leasehold Reform Act 1967.

2. Although the FTT issued three separate decisions they heard the applications together. In each case JGS Properties Limited (the appellant) was represented by Mr Kenneth Davis FRICS and the respondents by Mr Keith Waller.

3. The FTT determined in each case (and for identical reasons) that the appropriate deferment rate was 5.5%. Permission to appeal against the FTT’s decision on this issue was granted by the Tribunal on 2 December 2016.

4. Permission to appeal was also granted against an apparent accidental error by the FTT in the figure it adopted for the standing house value of 206 Damson Lane. It said that the value was £305,000 but put £300,000 into its valuation. In its amended decision dated 25 August 2016 it revised its opinion and said the standing house value should be £300,000 but gave no reasons for doing so. However, on 6 January 2017 Mr Waller, on behalf of the respondent, agreed to the figure of £305,000 as the standing house value of 206 Damson Lane and so this is no longer in dispute.

5. The Tribunal directed that the appeals should be heard together and determined as a review of the decisions of the FTT with a view to a rehearing. Both the review and the rehearing were directed to be conducted under the Tribunal’s written representations procedure.

6. Written submissions on behalf of the appellant were made by Ms Ellodie Gibbons of counsel and an expert report was received from Mr Kenneth Davis FRICS, a consultant with Cottons Chartered Surveyors. On 6 January 2017 Mr Waller wrote to the Tribunal on behalf of the respondents saying they did not wish to participate in the appeals otherwise than by way of a short “overview” that accompanied his letter.

Facts

7. Solihull is a sought after residential location and enjoys good transport links to Birmingham City Centre and London. It is in close proximity to the National Exhibition Centre and Birmingham

International Airport. 206 Damson Lane is a three-bedroom detached house on the Hampton Coppice Estate developed in the 1970s. 82 Stanbrook Road and 5 Welham Croft are three and four bedroom detached houses respectively on the Sandersfield Pastures Estate developed in the early 1980s.

8. 206 Damson Lane was let for 99 years from 24 June 1976 at an initial ground rent of £75 which doubled after 33 years and will double again after 66 years. The valuation date is 21 October 2015 at which time the unexpired term of the lease was 60.63 years.

9. The leases on the other two houses both commenced on 24 June 1983 for a term of 99 years. The amount of the ground rent and the pattern of stepped increases was the same as that at 206 Damson Lane. The valuation date is 21 August 2015 (66.8 years unexpired) for 5 Welham Croft and 30 September 2015 (66.75 years unexpired) for 82 Stanbrook Road.

10. Before the FTT Mr Davis argued for a deferment rate of 5.25% and Mr Waller 5.5%.

Review

The FTT's decision

11. The wording of the FTT's decision on the deferment rate issue was the same in each case:

“62. The Tribunal accepts the starting point and the principles enunciated in the case of *Sportelli* and has given due consideration to the cases thereafter that have been referred to by the parties.

63. Neither representative suggested the property would not be standing in 68 years and a deduction has been made from the reversion to reflect the risk of a tenant remaining in occupation at the end of the lease.

64. Mr Davis's arguments, have been carefully considered by the Tribunal, however the Tribunal is not persuaded to reduce the rate as suggested and consequently adopts a deferment rate of 5.5% calculated as follows:-

Risk free rate		2.25%
[minus] Real growth rate		<u>2.00%</u>
		0.25%
Risk premium	4.50%	
Obsolescence	0.25%	
Poorer growth outside PCL	<u>0.50%</u>	<u>5.25%</u>
		<u>5.50%</u> ”

Discussion

12. The FTT seemed to take *Sportelli* as the starting point for its consideration of the deferment rate (but see paragraph 18 below). It said that it gave “due consideration” to the other cases referred

to by the parties. These included *Re Sinclair Gardens Investments (Kensington) Limited's Appeal* [2014] UKUT 0079 (LC) in which the Tribunal reviewed post-*Sportelli* authorities in both Greater London and the West Midlands. On the circumstances which would justify an allowance to reflect obsolescence the Tribunal concluded at paragraph 82:

“It will only be in exceptional cases that the risk of deterioration will not be reflected in the vacant possession value of a property. Something more than age or a current poor condition is required to justify any additional allowance.”

13. The FTT offered no explanation of why it considered an additional 0.25% should be added to the deferment rate for obsolescence. There was no evidence to support that conclusion. Mr Davis contrasted the relatively poor quality of the accommodation at Kelton Court (*Zuckerman v Trustees of the Calthorpe Estate* [2009] UKUT 235 (LC)) with three detached houses on two desirable residential estates in Solihull. Mr Waller, who holds no relevant qualifications, said the starting point for the determination of the deferment rate was 4.75% (*Sportelli*) “then added 0.75% as provided for in *Zuckerman* ... to reflect the increased risk of deterioration and reduced growth.” That is what the FTT seemed to have done and it was wrong to do so without evidence or explanation.

14. The FTT did not explain why it made an allowance for obsolescence in circumstances where the reversion at the end of the lease was to a section 15 rent derived from the site value and not to the value of the standing house, i.e. the valuation was done in three stages following *Re Clarise Properties Limited's Appeal* [2012] UKUT 4 (LC). Both Mr Davis and Mr Waller referred the FTT to *Re Mansal Securities Limited's Appeal* [2009] 2 EGLR 87, in which the Tribunal accepted at paragraph 23 that “a site was not subject to obsolescence in the way that a house was and was less likely to deteriorate than a house.”

15. Similarly the FTT did not explain why it added 0.5% to the deferment rate to reflect “poorer growth outside PCL.” In paragraph 75 of *Sinclair Gardens* the Tribunal noted that although *Sportelli* was the starting point for the determination of the deferment rate, the Court of Appeal did not suggest the further evidence that might be called in cases directly concerned with areas other than prime central London (“PCL”) would have to be especially cogent or compelling to justify a departure from the *Sportelli* rates. But there must be *some* evidence to support such a departure.

16. Mr Waller cited *Mansal* and *Zuckerman* and three decisions of the FTT in 2014 as supporting his view that the deferment rate should be 5.5%, including an addition of 0.5% for “the reduced growth rate in the West Midlands.” In fact the Tribunal in *Mansal* (where four of the 22 properties were in Solihull) found there was “insufficient evidence” to displace the *Sportelli* rate on the grounds of location and adopted a rate of 5%. This included an addition of 0.25% because the reversion in a section 9(1) case was to a ground rent only and “a potential purchaser is likely to require a higher risk premium to compensate for the increased volatility and illiquidity than if the reversion also included a house standing on the site.”

17. Mr Davis provided evidence to the FTT about the growth rates of capital values in the Sandersfield Pastures and Hampton Coppice Estates and compared these with the corresponding

figures for Kelton Court (*Zuckerman*). He said this evidence showed “beyond doubt” the appeal properties had enjoyed superior growth to Kelton Court and that no addition to the deferment rate was justified.

18. The FTT said although it had considered Mr Davis’s arguments carefully it was not persuaded “to *reduce* the rate as suggested” (my emphasis). The FTT therefore seems to have been starting from a rate of 5.5% (*Zuckerman*) rather than the correct rate of 4.75% (*Sportelli*). That indicates that the FTT was not, despite its statement to the contrary, starting at the correct deferment rate but rather was presuming the *Zuckerman* deferment rate applied unless there was evidence to displace that presumption. That is not the correct approach.

19. In my opinion the appellant’s challenge to the FTT’s decision has been made out. The FTT did not sufficiently explain why it was satisfied that the deferment rate should be increased to 5.5%. Its decision must therefore be set aside. Having determined that the appellant has succeeded on the review it is necessary to consider the matter afresh upon the evidence now presented.

Rehearing

20. In his expert reports to this Tribunal Mr Davis said that the appropriate deferment rate was 5.25%, constituted as follows:

Risk free rate		2.25%
Minus real growth rate		<u>(2.00%)</u>
		0.25%
Risk premium	4.50%	
<i>Mansal</i> addition	0.25%	
Poorer growth rate outside PCL	<u>0.25%</u>	
		<u>5.00%</u>
Deferment Rate		5.25%

21. The “*Mansal*” addition was not made for obsolescence because Mr Davis relied upon the Tribunal’s conclusion in that case that a site was not subject to obsolescence in the same way as a house is (see paragraph 14 above). But it is not clear from Mr Davis’s expert report what the *Mansal* addition refers to. I assume it is for the increased risk of volatility and illiquidity that the Tribunal held applied to sites compared to a standing house and for which the Tribunal added 0.25%. Mr Davis explained why he considered freehold ground rents to be liquid assets. In *Mansal* the Tribunal adopted a two-stage valuation approach and concluded that given the volatility of site value (by reference to the gearing effect of residual valuations) “there might also be a resultant increase in the time needed to achieve a sale of such an investment.” Mr Davis said that marketing a ground rent (which is the relevant consideration where, as here, a three-stage valuation approach is adopted) does not carry the same risk of illiquidity as the sale of a site.

22. Mr Davis did not deny an adjustment should be made for the increased risk of volatility. Although it was not part of Mr Davis's evidence I note that the decision in *Mansal* relied upon an analysis that assumed site value is derived from "a residual calculation". That is certainly one way to obtain a site value (where direct sales evidence is unavailable) but a section 15 rent is the letting value of the site "without including anything for the value of buildings on the site". It is not required to disregard the existence of the house on the site and the exercise is not one of valuing a vacant site for development by a single detached house. Instead one is valuing a site that is secured by the existing house. As Hague: Leasehold Enfranchisement, Sixth Edition, says at paragraph 8-05:

"However, what has to be valued is the site as it is (i.e. with the existing buildings on it), but disregarding the value of the buildings, as opposed to a new development site."

In paragraph 27 of its decision in *Mansal* the Tribunal said that in the case of section 9(1) since the reversion is just to a ground rent, a potential purchaser is likely to require a higher risk premium to compensate for the increased volatility and illiquidity "than if the reversion also included a house standing on the site." But the reversion *does* include a house standing on the site; it is only its value that must be ignored.

23. The capital value of the site is usually found by using the cleared site approach (by reference to direct sales comparables) or the standing house approach (by reference to the entirety value). In *Mansal* and in these appeals the parties relied on the standing house approach and took the site value as a percentage of the entirety value. The increased risk of volatility referred to in *Mansal* reflected the gearing effect that is found in a residual valuation. That effect is absent where the site value is taken as a (fixed) percentage of the entirety value since the site value will then be directly proportional to the entirety value and will be no more or less volatile than the house value from which it is derived. It seems to me that the site value may not be as volatile as suggested in *Mansal* and that Mr Davis's acceptance of a 0.25% adjustment is generous. I do not think it is justified in this instance.

24. Mr Davis also made a 0.25% addition to the deferment rate for the lower growth rate outside prime central London ("PCL"). In doing so he relied upon research he presented to the FTT about the relative growth rates of the Sandersfield Pastures Estate, the Hampton Coppice Estate and Kelton Court (*Zuckerman*). He also produced new evidence of capital value growth obtained from the Land Registry House Price Index for the period 1996 to 2016 (21 years).

25. Mr Davis prepared three graphs showing the movement in the average sale prices for Kelton Court and the two Solihull Estates from 1975 to 2015. He said this graph was based on data derived from sales information "extracted from clients' records", the Land Registry and Rightmove. The only information provided about the data was that it comprised the following number of transactions:

Hampton Coppice	110
Sandersfield	122
Kelton Court	59

Sales in the early years were “on a leasehold basis” and in more recent years comprised extended leaseholds for Kelton Court and freeholds for the two Solihull Estates. No details were provided of any of the sales.

26. The graphs are hand drawn lines and seemed to be Mr Davis’s estimate of the “best-fit” between a limited number of data points each of which he showed marked with an “X” on the graph. There are 12 such points shown for the two Solihull Estates and 20 for Kelton Court. The first data point for the Solihull Estates was in 1984 and that for Kelton Court was in 1975 (although the next data point at Kelton Court was in 1994 and the growth in this 20 year period is represented by a straight line between just two points).

27. I do not find these graphs helpful. There is no reproduction of the source material and no explanation of the data points shown on the graph. It is possible that each point represents the average of the sale prices in a particular year but if that is so there are significant periods where no data has been obtained. Thus for the Solihull Estates there is no data point between 1991 and 2000 and none between 2007 and 2015 which means Mr Davis assumes constant growth throughout the period of the financial crisis from 2008. That is not realistic. Nor does Mr Davis’s graph distinguish between the data points for the two Solihull Estates. He produced two graphs, one including Hampton Coppice and one excluding it. But the number of data points did not change between them.

28. Accurately fitting a curve to a series of data points is not simply a matter of drawing a freehand line between them. The difficulties of determining the best fit curve for a graph were considered in Appendices B and C to the decision in *The Trustees of the Sloane Stanley Estate v Mundy* [2016] UKUT 0223 (LC). Mr Davis also relies on a mix of leasehold and freehold data with no information about the lengths of the unexpired terms of the leases at the date of sale. There is no way of knowing to what extent like is being compared with like.

29. Mr Davis concluded that “the current graphs show clearly growth rates of detached houses on this estate outstrip those of plain unattractive flats in Kelton Court.” But Mr Davis does not provide any quantified comparison between the two rates of growth and relies solely upon the visual impression formed by his graphs. It is obvious that the flats in Kelton Court are worth less in absolute terms than the detached houses on the Solihull Estates (although Mr Davis shows the graphs of Hampton Coppice and Kelton Court as being coincident in 1980 which means they had the same value at that time; an unlikely situation). What matters are the relative rates of growth and the appearance of the graphs can be deceptive. For example, doing the best I can from the graphs but without the numerical base data I estimate that the growth between 2000 and 2005 was higher at Kelton Court (13.3% per annum) than at either Sandersfield (12.3% per annum) or Hampton Coppice (10.6% per annum).

30. In *Sinclair Gardens* the Tribunal noted that the further evidence which might be called in cases outside PCL would not have to be “especially cogent or compelling to justify departure from those [*Sportelli*] rates” (paragraph 75). Mr Davis sought to show that the departure from those rates that had been accepted by the Tribunal in *Zuckerman* (Kelton Court) was not justified in these appeals

because the growth in capital value was much higher in the Solihull Estates than in Kelton Court. In my opinion the evidence of growth rates that Mr Davis presented to the FTT and continues to rely on before the Tribunal does not sustain his argument.

31. Mr Davis produced further evidence of rental growth in these appeals based upon an analysis of the Land Registry House Price Index. He provided details of the real growth of detached houses in (i) Solihull and (ii) the West Midlands for the 21 year period 1995-2016. The analysis showed real growth rates of 3.51% and 3.50% respectively which Mr Davis said exceeded the real growth rate in *Sportelli* “by a substantial margin”. The problem with this analysis is the absence of any comparison with real growth rates in PCL over the same period. *Sportelli* and subsequent cases considered growth rates in the long term, not just over 21 years. For Mr Davis’s approach to be valid he should have included the corresponding figures for PCL. His failure to do so means his additional evidence does not carry weight other than to show that the growth rate in Solihull is no greater than the rest of the West Midlands over the selected period.

32. In my opinion Mr Davis has failed to demonstrate that detached houses in Solihull have a growth rate more in line with PCL than with Kelton Court where the Tribunal accepted a 0.5% addition to the deferment rate was justified. In *Sinclair Gardens* the Tribunal said at paragraph 76:

“Particular care should be taken in drawing firm conclusions from statistical material where the basis on which it has been compiled and its application to the subject property are uncertain. It will be recalled that in *Mansal* the Tribunal was not prepared to draw definite conclusions from statistical material because there was insufficient information on how the material had been compiled, how its ingredients had been weighted and of what they consisted to enable a conclusion to be reached on its reliability as a basis for determining a long term growth rate for the West Midlands.”

Mr Davis correctly started from the deferment rate adopted in *Sportelli* but his analysis was not sufficiently rigorous to establish his hypothesis that the growth rate of detached houses in Solihull was the same as that in PCL. His acceptance of a 0.25% addition to the deferment rate for the difference in growth rates between Solihull and PCL suggests that he did not really believe this himself. In the absence of persuasive evidence that there is no difference in the deferment rates between the two areas it is reasonable to rely, as the FTT did, on the decision in *Zuckerman* which itself heard evidence and representation that “were of a much higher calibre than might ordinarily be expected in relatively modest cases.” (*Sinclair Gardens* at paragraph 77). I believe the FTT was wrong to start from the deferment rate in *Zuckerman* and to consider whether there was evidence to displace it. The difference in approach between Mr Davis and the FTT is subtle but important; the starting point should *always* be the *Sportelli* deferment rate.

33. I therefore uphold the FTT’s decision to add 0.5% to the deferment rate for the risk of a lower growth rate at the appeal properties.

34. I have considered Mr Waller’s letter to the Tribunal dated 6 January 2017 but found it to be of no assistance on this issue.

Determination

35. I determine the deferment rate at 5.25%:

Risk free rate		2.25%
Minus real growth rate		<u>(2.00%)</u>
		0.25%
Risk Premium	4.50%	
Poorer growth rate outside PCL	<u>0.50%</u>	<u>5.00%</u>
Deferment rate		5.25%

36. This is the deferment rate adopted by Mr Davis for the appellants albeit constituted differently. The appeal is therefore allowed and the premiums payable are determined as follows:

- (i) 206 Damson Lane, Solihull (LRA/130/2016): £8,175
- (ii) 82 Stanbrook Road, Shirley, Solihull (LRA/131/2016): £7,375
- (iii) 5 Welham Croft, Shirley, Solihull (LRA/132/2016): £7,775

Details of the calculations are given in the attached appendix.

Dated: 19 June 2017

A J Trott FRICS
Member, Upper Tribunal (Lands Chamber)

APPENDIX

UPPER TRIBUNAL (LANDS CHAMBER) VALUATION

(1) 206 Damson Lane, Solihull (LRA/130/2016)

- (i) Capitalised value of ground rent (not in dispute) = £2,853
- (ii) First reversion

Entirety value	=	£305,000	
Site apportionment @ 35%	=	£106,750	
Section 15 modern ground rent @ 5.25%	=	£ 5,604	
x Y.P. 50 years @ 5.25%	=	17.573	
x P.V. of £1 in 60.63 years @ 5.25%	=	<u>0.045</u>	
			£4,432

(iii) Second reversion

Standing house value	=	£305,000	
Schedule 10 deduction @ 2.5%	=	£297,375	
x P.V. of £1 in 110.63 years @ 5.25%	=	<u>0.003</u>	
			£ 892
			£8,177
			say <u>£8,175</u>

(2) 82 Stanbrook Road, Shirley, Solihull (LRA/131/2016)

(i) Capitalised value of ground rent (not in dispute) = £2,693

(ii) First reversion

Entirety value	=	£345,000
Site apportionment @ 35%	=	£120,750
Section 15 modern ground rent @ 5.25%	=	£ 6,339
Y.P. 50 years @ 5.25%	=	17.573
x P.V. of £1 in 66.75 years @ 5.25%	=	<u>0.033</u>

£3,676

(iii) Second reversion

Standing house value	=	£345,000
Schedule 10 deduction @ 2.5%	=	£336,375
x P.V. of £1 in 116.75 years @ 5.25%	=	<u>0.003</u>

£1,009

£7,378

say

£7,375

(3) 5 Welham Croft, Shirley, Solihull (LRA/132/2016)

(i) Capitalised value of ground rent (not in dispute) = £2,690

(ii) First reversion

Entirety value	=	£375,000
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Site apportionment @ 35%	=	£131,250	
Section 15 modern ground rent @ 5.25%	=	£ 6,891	
Y.P. 50 years @ 5.25%	=	17.573	
P.V. of £1 in 66.8 years @ 5.25%	=	<u>0.033</u>	
			£3,996

(iii) Second reversion

Standing house value	=	£375,000	
Schedule 10 deduction @ 2.5%	=	£365,625	
x P.V. of £1 in 116.8 years @ 5.25%	=	<u>0.003</u>	
			<u>£1,097</u>
			£7,783
			say £7,775