IN THE UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – Premium – whether allowance required to reflect difference in value of freehold and leasehold interests – whether allowance required to reflect absence of "Act rights" – use of LEASE graph to determine relativity – appeals allowed in part - premiums assessed at £13,136 and £18,545.

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

BY:

ELMBIRCH PROPERTIES PLC **Appellant**

Re: 51 and 85 Humphrey Middlemore Drive
Harborne
Birmingham
B17 0JJ

Hearing date: 4 July 2017

Martin Rodger QC, Deputy Chamber President, and Peter McCrea FRICS

Royal Courts of Justice, London WC2A 2LL

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Mr Paul Church for the Appellant
The leaseholders did not respond to the appeal

The following cases are referred to in this decision:

BPP Holdings Ltd v HMRC [2017] UKSC 55

Contactreal Ltd v Smith [2017] UKUT 178 (LC)

Crown Estate Commissioners v Whitehall Court London Ltd [2017] UKUT 242 (LC)

Nailrile Ltd v Earl Cadogan [2009] RVR 95

Sarum Properties Ltd v Webb [2009] UKUT 188 (LC)

Re: Coolrace Ltd [2012] UKUT 69 (LC)

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

Mallory v Orchidbase Ltd [2016] UKUT 468 (LC)

Introduction

1. These appeals are brought by Elmbirch Properties plc ("the appellant") against two decisions of the First-tier Tribunal (Property Chamber) ("the FTT") dated 9 November 2016, in which it determined the premiums payable under section 48(1), Leasehold Reform, Housing and Urban Development Act 1993 for the grant of new extended leases of two flats at Humphrey Middlemore Drive, Harborne, Birmingham, B17 0JJ. The premium payable for the new lease of flat 51 ("No. 51) was held to be £14,021, while £8,997 was payable for flat 85 ("No. 85").

2. The appellant is the owner of the freehold of the Humphrey Middlemore/Griffin Gardens estate which includes the two flats. It was represented at the hearing of the appeals, as it had been before the FTT, by Mr Paul Church, who called Mr Kieron McKeown MRICS to give expert valuation evidence.

3. The tenants of the two flats participated fully in the proceedings before the FTT, where they were represented by Mr Nick Plotnek and Mr Geraint Evans FRICS, who gave expert evidence, but they chose not to respond to the appeal. The Tribunal has nevertheless had regard to the expert evidence filed on the tenants' behalf when the proceedings were before the FTT.

4. Permission to appeal both decisions was refused by the FTT, but was granted by this Tribunal on 31 March 2017. The Tribunal directed that the appeals would be dealt with as a review of the FTT's decision with a view to re-hearing. In the event, as we shall explain, the Tribunal was satisfied that the decisions of the FTT were flawed and we proceeded to re-hear the applications in respect of both flats.

The relevant statutory provisions

5. Chapter II of the 1993 Act confers the right for the tenant of a flat to acquire a new lease of the flat on the payment of a premium calculated in accordance with the provisions of Schedule 13 to the Act. The new lease is for a term equal in duration to the unexpired term of the original lease plus an additional 90 years, and no rent is payable.

6. For the purpose of these appeals the premium payable for the new lease is the aggregate of the two sums specified in paragraph 2(a) and (b) of Schedule 13.

7. The first of these is the diminution in the value of the landlord's interest in the tenant's flat caused by the grant of the new lease. This is described in paragraph 3 of Schedule 13 and, in short, is the difference between the value of the landlord's interest in the flat prior to the grant of the new lease and the value of its interest once the new lease is granted, in each case assuming a sale on the open market subject to the relevant lease. For the purpose of the assumed sales the tenant is taken not to be a potential buyer and the 1993 Act is taken to confer no right to acquire any interest in any premises containing the tenant's flat or to acquire a new lease of that flat.

8. The second element of the premium is the landlord's share of the marriage value created by the grant of the new lease (but no marriage value is payable when the unexpired term of the current lease is more than 80 years). By paragraph 4 of Schedule 13 the marriage value is the difference between the aggregate of the value of the tenant's interest under the existing lease and the landlord's interest in the flat prior to the new lease being granted on the one hand, and the aggregate of the value of those interests after the grant of the new lease on the other. The landlord's share of the marriage value is 50% of this sum.

9. The determination of the premium therefore requires separate valuations of the existing lease and the new lease, and of the landlord's interest in the flat before and after the grant of the new lease.

Facts

10. Humphrey Middlemore Drive is a residential estate of around 70 units, constructed in the mid 1980's, set in landscaped grounds with car parking. The development comprises mainly one or two bedroomed flats in connected blocks, but there are six duplex maisonettes on the first and second floors, of three-storey brick buildings under pitched tiled roofing.

11. No. 51 is a ground floor flat with a hall, sitting room, kitchen, bedroom and bathroom. The FTT described it as a two-bedroomed flat, because at the time of their inspection the sitting room was in use as a bedroom, but for the purpose of valuation it is essential to treat it as a one bedroomed flat. The gross internal area is in the order of 40m^2, or 430 sq ft. At the valuation date it was in good condition, with double glazed windows, a new bathroom and new kitchen.

12. The long lease of No. 51 was granted on 20 June 1986 and is for a term of 99 years from 24 June 1985. The initial annual rent was £45, subject to a fixed increase on 24 June 2016 to £90, and a further increase on 24 June 2049 to £180. On 9 November 2015 the tenants, Shahsi Pal Aggarwal and Anjana Devi Aggarwal, gave the appellant notice under section 42 of the 1993 Act claiming a new lease for which they proposed a premium of £5,880. On 18 December 2015 solicitors for the appellants served a counter notice, acknowledging the tenants' right to a new lease, but proposing a premium of £21,400.

13. No. 85 is one of the six duplex units on the estate and has accommodation on the first and second floors comprising a hall, sitting room, kitchen, two bedrooms and a bathroom. Allowing for the restricted height of part of the second floor, it has a gross internal area of 71 m^2, or 736 sq ft. It has single-glazed timber casement windows, and at the valuation date was in reasonable but basic condition.

14. The lease of No. 85 is dated 27 June 1986 and is for a term of 99 years from 24 June 1985. The initial annual rent was £60, increasing on 24 June 2016 to £120, and on 24 June 2049 to £240. On 23 October 2015 the tenant, Ms Espie-Whitburn, served a notice claiming a new lease and proposing a premium of £7,480. On the same day, she exchanged contracts for

the sale of the flat at a price of £128,500. That sale was completed in November 2015. On 2 December 2015, solicitors for the appellant served a counter notice, acknowledging the tenant's right to a new lease, but proposing a premium of £27,600.

15. The valuation dates for the purposes of determining the premiums are the dates of the tenants' notices under section 42: 23 October 2015 in the case of No. 85, where the lease had 68.67 years unexpired on that date, and 9 November 2015 in the case of No. 51, where the unexpired term was 68.62 years.

16. Applications were made to the FTT in each case to determine the disputed premium, and a hearing of both applications took place on 10 August 2016. On the same day the FTT inspected both properties.

The FTT's decisions

17. The FTT determined that the premium payable for the new lease of No. 51 should be £8,997 on the following basis:

(1) The value of the current lease was £99,000 (as the experts had broadly agreed).

(2) The only available market evidence (the proposed sale of 45 Griffin Gardens) was unreliable as a guide to the value of the extended lease.

(3) The value of the extended lease was £112,385. This figure was derived from the current lease value, which was taken to be 92.84% of the value of the extended lease. The relationship between the two values (their "relativity") was derived from the graph compiled by the Leasehold Advisory Service, and published in the RICS Research Report "Leasehold Reform: Graphs of Relativity" of October 2009 ("the LEASE graph").

(4) No addition was required to the value of the extended leasehold value to arrive at a value for the freehold interest with vacant possession (although both experts had agreed that a 1% uplift was required).

(5) It was unnecessary to make any adjustment to reflect the fact that paragraph 3(2)(b) of Schedule 13 to the Act required that the diminution in value calculation be undertaken on the assumption that the tenant enjoyed no rights under the Act.

(6) The appropriate deferment rate was 5.5%.

18. The FTT's figure of £14,021 for No. 85 was based on the following findings:

(1) The price of £128,500 agreed to be paid for the existing lease on the valuation date was an unreliable guide to its value. The property had been sold with the benefit of the section 42 notice, leaving the purchaser to complete the lease extension; the FTT considered that because the tenant would have been keen to sell, and the purchaser

would have been both nervous and mindful of the cost of extending the lease, the agreed price was less than the market value of the lease.

(2) The extended lease value was £162,500, a figure arrived at without giving weight to evidence of the sale of a comparable property (No. 59) in 2012; the appellant had adjusted the sale price to the valuation date using the Land Registry index, but the FTT considered that index unreliable.

(3) As with No. 51, no addition was required to the value of the extended leasehold value to arrive at a value for the freehold interest, although both experts had adopted a 1% uplift.

(4) The deferment rate was 5.5%.

Issues

19. The issues which arise in this appeal are matters of valuation principle. It is important that a uniform and predictable approach is taken by first-tier tribunals to such issues, and (as the Supreme Court has recently reiterated in *BPP Holdings Ltd v HMRC* [2017] UKSC 55, at [26]) it is an important part of the function of this Tribunal to develop guidance so as to achieve consistency in the FTT, so that different practices are not adopted in different parts of the country.

20. Permission to appeal was given on the following issues:

(1) Whether, in each case, the FTT was entitled to disregard the agreement of both experts that the value of the extended lease should be increased by 1% to arrive at a freehold equivalent.

(2) Whether in both cases the FTT was wrong in principle to refuse to make an adjustment to values derived from real world comparables to reflect the statutory assumption that the diminution in the value of the landlord's interest is to be derived from an assumed sale of the existing and extended leases without the benefit of the rights conferred by the Act.

(3) Whether the FTT was wrong in principle to determine the value of the extended lease of No. 51 by adjusting the value of the current lease using a relativity derived from the LEASE graph, rather than by relying on evidence of market activity.

(4) Whether the FTT was wrong in principle to treat the sale of No. 85 with the benefit of a section 42 notice as unreliable evidence of the current lease value.

(5) Whether the FTT was wrong in principle to decline to adjust the sale price of a good comparable by reference to the Land Registry index when determining the value of the extended lease of No. 85.

21. Permission to appeal the FTT's finding that the appropriate deferment rate was 5.5% was refused. This refusal caused Mr McKeown to adjust his evidence on the premiums (which had previously been based on a deferment rate of 5%) to £17,706 for No. 51, and £26,695 for No. 85.

Issues 1: The freehold differential

22. In ascertaining the diminution in the value of the appellant's interest as a result of the grant of the new lease, the FTT declined to make any adjustment to the value of the long leasehold interest to reflect the fact that at the end of the term the landlord's interest would be a freehold interest with vacant possession. The FTT explained its approach on the basis that "an investor is unlikely to make a distinction between the long lease value and the vacant possession value".

23. The FTT's approach was wrong in principle and was not supported by evidence. Where the landlord's interest is the freehold reversion to the existing lease, as it is in these cases, the statutory assumption on the basis of which the diminution in the value of that interest is to be ascertained is of a sale of the freehold interest in which the tenant is not a buyer and enjoys no rights under the Act. On those assumptions (which are artificial and rarely encountered in reality) the purchaser of the landlord's interest would anticipate that on the expiry of the lease the flat would return to the then freeholder with vacant possession (it was not suggested in these cases that the tenant would take advantage of rights under Schedule 10 to the Local Government and Housing Act 1989).

24. It cannot sensibly be suggested that the unencumbered freehold interest which will come into the hands of the landlord at the end of the term is no different to a long lease, under which the tenant has liabilities, restrictions and obligations to the freeholder, irrespective of the length of lease. To assume that the two interests, which are different in nature, are nevertheless no different in value requires a substantial justification. The FTT's justification was that an investor would be unlikely to differentiate between the two interests, but it cited no evidence in support of that proposition; nor was it in a position to cite direct evidence, as the sale which the statute requires must be assumed is not one encountered in reality.

25. In the recent decision of the Tribunal (Mr A J Trott FRICS) in *Contactreal Ltd v Smith* [2017] UKUT 0178 (LC) the existence of a difference in value between a long lease and an unencumbered freehold of the same property was taken to be an established matter of valuation principle which ought not to be departed from except where there was evidence to justify that course (at [70] to [73]:

> "70. It is generally recognised that there is a qualitative difference between freehold and leasehold tenure and that a leasehold, however long its term, is not as valuable as an equivalent freehold. The relativity of even the longest lease may approach 100% but will not reach it. This valuation principle is reflected in many Tribunal decisions and in *Earl Cadogan v Erkman* [2011] UKUT 90 (LC) the Tribunal set out an appropriate range of relativities at paragraph 98:

> "Leases with unexpired terms of 100 to 114 years - 98%; 115 to 129 years - 98.5% and above 130 years - 99%."
>
> 71. The majority (but not all) of the graphs in the RICS Research Report "Leasehold Reform: Graphs of Relativity" show relativities of 100 year leases which are less than 100%. One graph that equates a 100 year lease with a freehold is that produced by Nesbitt & Co. In *Mallory v Orchidbase Limited* [2016] UKUT 0468 (LC) the Tribunal accepted the evidence of Mr Laurence Nesbitt of that firm that "in his experience a share of the freehold would make little difference to value when considering long lease values." The Tribunal found support for that view in the price achieved for a long leasehold flat which was higher (on a time adjusted basis) than the prices of three other flats in the same block each of which had a share of the freehold.
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> 72. In many cases before the Tribunal the relativity of a long lease is agreed between the parties and is unlikely to be disturbed, e.g. in *Denholm* the parties agreed, and the Tribunal accepted, that an extended 133.37 year lease had a relativity of 99%.
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> 73. It may be the FTT's experience in the Midlands that parties tend to agree the relativity of long leases at 100% although the reasons given by Ms Abel why this is so and her suggestion that the Midlands market is "immature" are not explained or convincing. Mr McKeown challenged the FTT's assertion that it was "not common practice" to discount the relativity by 1% and, in the absence of any evidence of the kind that persuaded the Tribunal in *Mallory* not to make such an allowance, I see no reason why such a discount should not properly have been made by the FTT, in accordance with Tribunal practice and valuation principle."

26. In these cases there was no evidence before the FTT to justify its conclusion, and the explanation which it gave is unconvincing in light of the statutory assumptions.

27. In any event, it was not open to the FTT to reach the conclusion which it did as both expert valuers adopted a differential of 1%. There was no dispute between the parties on this element of the valuation. Nor was this a case in which a party had made a concession without the benefit of professional representation, where the FTT might have been justified in investigating unwarranted assumptions. Both parties had the benefit of professional advice and in those circumstances it was not for the FTT to impose its own view, contrary to the agreed position.

28. The use of a 1% differential is a reasonable adjustment to make, agreed by the valuers at the FTT, and we have adopted it our own valuations in these appeals.

Issue 2: Adjustment for "Act rights"

29. The valuation exercise must be carried out on the basis of an artificial assumption. Chapter II of the Act provides that qualifying tenants may claim the right to a new lease, but paragraph 3(2)(b) of Schedule 13 requires that in determining the diminution in value of the landlord's interest as a result of the exercise of that right it must be assumed that no such right exists.

Moreover, the right conferred on tenants of flats collectively by Chapter I of the Act to acquire the freehold of the building must also be disregarded. Traditionally these assumption were referred to as the "no Act world", but since the assumption applies only to the subject property (the flat itself in the case of the tenant's right to a new lease, and the building in which it is contained in the case of collective enfranchisement), and not to the rest of the market (ie it is not assumed that the legislation was never enacted), it has more recently been termed the "no Act building" (see, for example, *Crown Estate Commissioners v Whitehall Court London Ltd* [2017] UKUT 0242 (LC) at [21] to [57]).

30. The benefits of the Act to a qualifying tenant are significant. They have been outlined in many of the Tribunal's decisions. In *Nailrile Ltd v Earl Cadogan* [2009] RVR 95 they were said to include: the legal right to enfranchise or extend the lease at a time of the leaseholder's choosing; a price fixed by an independent tribunal in the absence of agreement; the exclusion of the tenant's overbid whilst guaranteeing the tenant 50% of the marriage value; a fixed valuation date and delayed payment of the purchase price. The Tribunal contrasted these benefits with the position of a tenant assumed to be without the benefit of the Act who has no certainty of being granted a new lease and whose landlord is in an overwhelmingly strong negotiating position.

31. Where comparable transactions concerning premises with the benefit of the Act have been used to determine the value of the various interests, the statutory direction that the diminution in the landlord's interest is to be ascertained on the basis of notional transactions in which the benefit of the Act is assumed not to be available would seem in principle to require an adjustment to be made to the values suggested by the comparables. On behalf of the appellant Mr McKeown made a deduction of 4.28% for Act rights. Mr Evans made no such deduction, as his relativity figure was based on the five graphs for Greater London and England in the 2009 RICS Report in which he assumed that a "no Act world" had been reflected.

32. In its decision concerning No. 51 the FTT said of Mr McKeown's suggested adjustment that "in view of the length of the unexpired term of the lease it is not necessary to make... an adjustment". In its decision on No. 85 the FTT made no adjustment, but gave no reason.

33. The FTT's short explanation in respect of No. 51 is unconvincing, and it is not clear to us why the length of term should be relevant in principle to the need to make an adjustment. We appreciate of course that the value of the benefit of the Act may vary with time, but we do not accept that in a lease for an unexpired term of less than 70 years there is any basis on which it can be said to be either nil, or so insignificant as to be capable of being disregarded altogether.

34. In *Contactreal* the Tribunal reversed the decision of another West Midlands tribunal on this point, treating the need for an adjustment as a matter of valuation principle (at [31]):

> "Sales of leases without the benefit of the Act are, to all intents and purposes, hypothetical so there can be no direct comparison between sale prices with and without Act rights. But it has long been recognised by the Tribunal that having Act rights is a valuable benefit; see, for instance, *Nailrile Limited v Earl Cadogan* [2009] RVR 95 at paragraphs 216 to 217

and, more recently, *The Trustees of the Sloane Stanley Estate v Mundy* [2016] UKUT 0223 (LC) at paragraph 121. The amount of that benefit increases as the unexpired term reduces. It is beyond doubt that Act rights confer a benefit which is reflected in the value of leases in the actual market and which falls to be disregarded when calculating the premium payable for a new lease under the 1993 Act. This applies throughout England and Wales without exception; the West Midlands is no different to any other region in this respect."

35. In this case also we consider that the FTT was wrong in principle to refuse to make an adjustment to reflect the "no Act rights" assumption.

36. Mr McKeown's calculation of a deduction for Act rights was based on a straight line interpolation following two other Tribunal decisions – a deduction of 2.5% for an unexpired term of 78 years in *Sarum Properties Ltd v Webb* [2009] UKUT 188 (LC), and what was said to have been a 10% deduction for a term of 44 years in *Cadogan Estates v Cadogan Square Ltd* [2011] UKUT 154 (LC). He calculated that the deduction for No. 51, having 68.62 years unexpired, should be 4.38%, and for No. 85 with 68.67 years unexpired, 4.37%.

37. There are a number of difficulties with this approach. Any straight line between two points is only as reliable as the points selected, and the Tribunal has made a range of allowances for leases of different lengths. In *Contactreal* (in which Mr McKeown also gave evidence on the appropriate deduction for the benefit of the Act), the Tribunal pointed out, as had the FTT in that case, that the appeal in *Cadogan Square* concerned a much shorter unexpired term for which an allowance of 25% rather than 10% was made for the benefit of the Act. Additionally, to make a distinction of one hundredth of a percentage point to reflect a difference in lease length of only two weeks, as Mr McKeown's method does, suggests an unrealistic degree of precision in what ought to be approached as an exercise of judgment (see the Tribunal's observations to that effect in *Sloane Stanley* (at [168]) quoted in paragraph 71 below). We can see no reason why the same allowance should not be made in each of these cases.

38. In *Contactreal* the Tribunal made an allowance of 3.5% for an unexpired term of 67.49 years. We make the same allowance in these cases. The value of the short leasehold interest in No. 51 was found by the FTT to be £99,000; without Act rights we find the value of the same interest would be, say, £95,500.

Issue 3: The value of the extended lease of No. 51

39. Before the FTT, Mr McKeown had relied upon a proposed sale of 45 Griffin Gardens ("No. 45") as evidence to establish the value of the extended lease of No. 51. No. 45 was a flat within the same block as No. 51 for which terms of sale had been agreed in May 2016 at a price of £123,000, with the benefit of an extended lease. To reflect the higher ground rent of £350 payable under the lease of No. 45 Mr McKeown made an adjustment of £4,500, to arrive at an equivalent value of £127,600. A second adjustment was made, using the Land Registry index, to allow for movement in values in the six months from the valuation date of November 2015 to the agreement of terms in May 2016, giving an adjusted value of £127,600. Mr

McKeown submitted that this market evidence obviated the need to refer to any graph of relativity.

40. On behalf of the tenants Mr Evans had worked from the value of the current lease which he took to bear a relativity of 91.66% to the extended lease. He derived this relationship from five relativity graphs, as the Tribunal (Mr P R Francis FRICS) had done in *Re Coolrace Ltd* [2012] UKUT 68 (LC). The resulting extended lease value was £106,910.

41. The FTT dealt with this issue as follows:

> "49. As far as the extended lease value is concerned the Tribunal prefers to rely on market evidence where available although in this case it is apparent to the Tribunal that the sale of 45 Griffin Gardens is not directly comparable to the subject property due to the significantly increased ground rent which itself further increases every 10 years. The Tribunal does not accept that the allowance made by the Applicant adequately reflects this and it prefers the evidence of Mr Evans although applying the LEASE graph indicates a relativity of 92.84% which results in an extended lease value of £112,385.00. The Tribunal therefore adopts this figure. The Tribunal considers it to be most appropriate and therefore determines that the value of the extended leasehold interest is £112,385.00 based on the existing leasehold value of £99,000.00."

42. The FTT's explanation was slightly opaque, but we understand its methodology to be this: if the existing lease value for the 68.62 years unexpired is £99,000 which on the LEASE graph has a relativity of 92.84% of freehold value, the same graph can be used to arrive at an extended leasehold value, with a relativity of 99%.

43. We cannot accept this aspect of the FTT's decision for the following reasons.

44. First, the LEASE graph, on which the FTT relied, is based solely upon LVT decisions from 1994 to 2007; it has been the subject of some criticism and was used by the Tribunal in *Coolrace* with reluctance and only in the absence of any better evidence (see *Coolrace* at [27]).

45. Secondly, if our understanding of the FTT's methodology is correct, there is an arithmetical error in its calculation, since £99,000/0.9284 produces a long lease value of £106,635, and not £112,385. On the other hand, if the FTT's arithmetic is sound and it is our understanding of its methodology which is faulty, the FTT's decision has not been adequately explained.

46. Thirdly, and in any event, the FTT's calculation makes no allowance for the necessary disregard of the value of Act rights which, for the reasons we have already given, reduces the notional value of the existing lease which should be taken to be £95,500.

47. We would add finally that the reason the FTT gave for placing no weight on what it called "the sale of 45 Griffin Gardens" is also puzzling. If, as appears to have been the case, the FTT was not troubled by the fact that the sale had not completed, an agreement for the sale of a similar flat, in the same block as the subject property only six months after the valuation date should have been strong evidence. A competent valuer should certainly be capable of making an adjustment to reflect the differing ground rent pattern of the comparable and the FTT did not explain what it found unsatisfactory about the allowance Mr McKeown proposed.

48. We are satisfied that the FTT's conclusion that the value of the extended leasehold interest of No. 51 is £112,385.00 cannot stand. We have therefore considered the evidence on that issue (including the evidence of Mr Evans) and the relevant submissions afresh.

49. Mr McKeown confirmed that, in the event, the sale of No. 45 had not been completed. Nevertheless, initially at least, he relied on the fact that it had been marketed at an asking price of £125,000 as a cross check in the light of other evidence.

50. He also pointed to the sale of 65 Humphrey Middlemore ("No. 65"), in April 2010 at £115,000 which, in his evidence to the FTT, Mr Evans had adjusted for time using the Land Registry's house price index for "Birmingham – flats and maisonettes" to arrive at £128,084 as the equivalent sale price at the valuation date. No. 65 had been in similar condition to No. 51. Mr McKeown said that it would be entirely far-fetched to conclude that No. 51 was worth only around £112,500 in 2015 when No. 65 had been sold for £115,000 in 2010, as the Land Registry index showed that values had increased substantially in that five-year period.

51. There was a slight discrepancy in the use by the experts of the Land Registry house price indices. We are satisfied that Mr Evans was correct in using the Birmingham table for "flats and maisonettes" to adjust the sale price of No. 65. Mr McKeown believed he had done the same when he adjusted the price agreed for No. 45 but it is apparent that the figures he relied on came from the Birmingham "all property types" index. In any event Mr McKeown effectively abandoned his former reliance on the uncompleted agreement for No. 45.

52. As for relativity, Mr Church submitted that the LEASE graph should not be used because it had, he said, been criticised by the Tribunal (Morgan J and Mr A J Trott FRICS) in *The Trustees of the Sloane Stanley Estate v Mundy* [2016] UKUT 0223 (LC). In fact, the LEASE graph was not referred to in *Sloane Stanley*, as the Tribunal has recently pointed out in *Contactreal*, but Mr Church's point is nevertheless a good one, as the Tribunal explained (at [37]):

> "In [*Sloane Stanley*] the Tribunal criticised and dismissed the College of Estate Management Graph which comprised data derived solely from LVT decisions. The LEASE graph is similarly constructed and I derive no assistance from it."

The same reservations about the use of the LEASE graph were expressed by the Tribunal (His Honour Judge Hodge and Mr P D McCrea FRICS) in *Mallory v Orchidbase Ltd* [2016] UKUT 0468(LC) at [39]

53. Mr Church also referred to a 2015 decision of the FTT concerning two flats in Sutton Coldfield in which the FTT had been persuaded that the evidence provided by other tribunal decisions suggested the LEASE graph's relativity rates were too high by around 8%. FTT decisions are not reliable evidence of value or relativity but Mr Church was entitled to submit that the decisions mentioned in the Sutton Coldfield case demonstrated lower relativity rates than the historic LVT decisions on which the LEASE graph is based.

54. Mr McKeown accepted that the evidence on the value of the extended lease showed a very mixed picture. He preferred to place weight on the adjusted sale of No. 65, more than five years before the valuation date, rather than use a graph to adjust existing lease value.

55. Although No. 65 appears to be have been a very similar flat to No. 51 its utility as a comparable is limited by the significant lapse in time before the valuation date. Using Mr Evans' indices to adjust the April 2010 sale price points to a valuation date equivalent of £128,084. As Mr McKeown pointed out, for No. 65 to have sold for £115,000 in April 2010, after which date values have risen, suggests that the extended lease of No. 51 cannot have been worth less than that sum in November 2015.

56. There is also the evidence, such as it is, of "market expectation" in the form of the marketing of No. 45 at £125,000, which produced an offer in May 2016 of £123,000. If, in the absence of any evidence to the contrary, Mr McKeown's adjustment of £4,500 is taken to reflect the higher ground rent at No. 45, the resulting figure would be £127,600. Adjusting for time using Mr Evans' index produces a notional "under offer" figure of £123,180.

57. If it were necessary to rely on a graph, Mr McKeown said that the market still used the Gerald Eve graph as the "least unreliable" option. For the West Midlands he thought that around 2% should be deducted from Gerald Eve relativity to reflect that the premises were outside Prime Central London and to take account of their particular regional location. For unexpired terms of 65-70 years the Gerald Eve graph showed a relativity of 84% - 87%. In his oral evidence Mr McKeown also mentioned a graph which he compiled, based on his settlements and negotiations, which he said showed 82.5% for 67 years, and 82.95% for 68 years unexpired.

58. The graph evidence, as interpreted by Mr McKeown, might suggest a relativity figure of around 84%. Based on a value of £95,500 for the existing leasehold interest without Act rights, a notional freehold figure of £113,690 would result, giving a value of around £112,500 for the long leasehold interest.

59. This review shows how thin the available evidence is. Good market evidence should always be preferred to graphs where it is available, but here that evidence is limited to a notably historic transaction adjusted by reference to a general index spanning five years, and a second "comparable" which is the evidential equivalent of Sherlock Holmes' "dog in the night-time" in that nothing happened; unlike Holmes, however, we deduce little from it.

60. What can be without question is that the long leasehold value of No. 51 would not be less than £115,000, for the reasons given by Mr McKeown. The adjusted "under offer" price of £123,180 for No. 45 must represent a ceiling, since no purchaser was willing to pay it. In our view, the little market evidence there is seems to point to an extended lease value between £117-£120,000.

61. In the light of this very limited market evidence, we are willing to place some weight on the relativity graphs. These suggest that a figure at the lower end of the identified range is appropriate.

62. We therefore consider that the market value of the long leasehold interest in No. 51 at the valuation date was £117,000. This would mean a notional freehold value of say £118,200, and the short leasehold value of £95,500 without Act rights would amount to a relativity figure of about 81%.

63. Our conclusions in this unopposed appeal and on this limited evidence should not be relied upon as a precedent for relativity levels, or other adjustments, in other cases which should continue to be determined on the evidence adduced in those cases.

Issues 4 and 5: the valuation of No. 85

64. No. 85 was sold with the benefit of its existing lease and a notice claiming a new lease on the valuation date, at a price of £128,500. The FTT explained its reasons for placing no weight on this transaction, in the following passage of its decision:

> "28. The Tribunal is of the opinion that in reality any purchaser would be nervous in taking on a short lease with simply the promise of being able to extend the lease and this will inevitably be reflected in the bid for the property. Far from the service of a Notice of Claim enhancing the figure the vendor is likely to get, it is actually likely to depress it, particularly if, as the Tribunal may reasonably assume here, having put the property on the market the vendor is keen to sell.
>
> 29. The purchaser would have to assume that the best indication he has of the cost of obtaining a new lease is the figure being demanded by the freeholder which in this case the Tribunal can assume was not going to be less than the £27,545.00 which Elmbirch is demanding. In this case, it is reasonable to assume that the purchaser would be likely to take the attitude that despite any assurances from anybody else the only information he has at the moment, is that the extended lease is going to cost him some £27,500 plus costs of say another £2,500.00. The purchaser would then have to take into account the value of the property with an extended lease and in this case he would inevitably give consideration to the sale evidence available to him in respect of numbers 33, 55 and 87 which average £151,300.
>
> 30. Even if the Tribunal considers the earliest sale in August 2012 of number 33 as being historical the adjusted figures for the two latest sales numbers 55 and 87

> produce an average of £146,000.00. If this is adopted these properties will be worth nearly 15% more than number 85 at the appropriate day. The Tribunal does not consider this to be realistic and concludes that the sale price of number 85 in November 2015 is, in the particular circumstances of this case, unreliable. The figures for the value of the existing leasehold interests of the three comparables suggest a valuation in the region of £142,500 which the Tribunal considers to be realistic."

65. The notion that the value of a leasehold interest may be depressed if it is offered for sale with the benefit of a notice of claim does not withstand scrutiny, and the opposite is clearly the case. Nor is it at all obvious why a vendor who serves such a notice may be assumed to be any more "keen to sell" than any other owner who offers their property on the market. The service of a notice by a vendor does not commit the purchaser to proceeding with a lease extension, but where no notice has been given the purchaser is at a significant disadvantage. By section 39(2) of the 1993 Act a purchaser must wait for the expiry of a two year qualifying period before being in a position to make claim for an extended lease. During that time, as the unexpired term of the lease becomes shorter, the premium to be paid for an extended lease may rise significantly, especially if the threshold of 80 years after which marriage value must be taken into account is crossed. It is thus very common for leases to be offered to the market with the benefit of a notice.

66. We are therefore satisfied that the FTT's basic premise was incorrect and that its valuation, which ignored the most obviously relevant comparable, cannot stand. It also wrongly assumed that the prospective purchaser would "inevitably give consideration to the sale evidence available to him in respect of numbers 33, 55 and 87 with average £151,300". While a well advised purchaser might be assumed to be aware of the prices being paid for similar properties in the area held on extended leases, at the valuation date the sale of No. 87 was some months in the future and could not have been known. Nor could the purchaser have known the price which the appellant would ask for an extended lease, since the counter-notice containing that figure was not given until after completion of the contract of sale. When contracts were exchanged the appellant had not yet received the notice of claim and there was no evidence that it had been asked for, or had given, any indication of the price it would seek.

67. It is therefore necessary for us now to consider the evidence afresh.

68. Neither valuer made any adjustment for the 28-day period between the service of the section 42 notice, on which date contracts were exchanged, and the completion of the sale in November 2015. Nor do we. Although there was some very small difference in the index, which rose from 105.46 in October 2015 to 105.63 in November, for the purpose of analysing the sale of No. 85 what is important is that the date on which the sale price of £128,500 was agreed was also the valuation date.

69. An open market transaction in which the property to be valued has changed hands at or around the valuation date must be the starting point for a valuation. As the Tribunal remarked in *Sloane Stanley* (at [168]):

"…it is likely that there will have been a market transaction at around the valuation date in respect of the existing lease with rights under the 1993 Act. If the price paid for that market transaction was a true reflection of market value for that interest, then that market value will be a very useful starting point for determining the value of the existing lease without rights under the 1993 Act. It will normally be possible for an experienced valuer to express an independent opinion as to the amount of the deduction which would be appropriate to reflect the statutory hypothesis that the existing lease does not have rights under the 1993 Act."

70. It is therefore necessary to consider whether there is any other evidence which would suggest that the sale price was not "a true reflection of market value". We remind ourselves at this point that there are only six duplex units in the whole complex. There was evidence of transactions on five of the six, including a sale of No. 85 itself. Mr McKeown agreed with Mr Evans' adjustment of the sale prices using the Land Registry "flats and maisonettes" index, to give the following:

Property (Humphrey Middlemore Drive)	Sale Date	Price	Price at October 2015	Comments
33	August 2012	£142,500	£161,836	71.8 yrs remaining, in better condition, with upvc double glazing. Not in same block as the subject property.
59	November 2012	£152,000	£173,747	99 years from Feb 2008 - 70.6 yrs remaining, upvc double glazing. Not in same block as subject property.
55 Griffin Gardens	November 2013	£140,000	£155,202	New lease of 189 yrs from 24 June 1985 granted on 20 June 2014. Refitted bathroom, upvc double glazing.
85	October 2015	£128,500		
87	January 2016	£138,000	£136,897	68 yrs remaining, refitted kitchen and bathroom, upvc double glazing. In same block as the subject property, sold two months after valuation date.

71. On an adjusted basis the sales of No. 33 and No. 59 suggest that the sale price of No. 85 was low. Mr Church submitted that these could be discounted as they were in different blocks, and were in better condition than the appeal property. We do not agree they can simply be

ignored, as they are in the same complex, and are two of only six duplex units, but we are mindful that their use as comparables is dependent upon the application of an index for a period of over three years at a time when prices were evidently rising significantly.

72. Using Mr McKeown's logic, in a rising market and all other things being equal, the value of No. 85 should not be less than that of, say, No. 55 - £140,000. But other things are not, or may not, be equal. The three flats are in different locations in the complex; they are not in the same condition; and the unexpired terms vary from 71.8 years (No. 33), 70.6 years (No. 55) and 68.67 years (the subject property).

73. Mr Evans referred to the extended lease of No. 55, granted in June 2014. It seems likely that this new lease was negotiated and completed following a notice given before the sale of the property for £155,202 in November 2013, but there is no evidence to confirm this.

74. Other than the transaction on the subject property, we agree with Mr McKeown that the best comparable is No. 87, which was sold in January 2016 (three months after the valuation date) at £138,000. It is in the same block as the subject property, and had a very similar unexpired term. Indexing back using the Land Registry data, the sale price equates to £136,897 at the valuation date. Mr McKeown considered the difference in price between No. 85 and No. 87 was because No. 87 was in better condition – No. 85 only having timber casement windows, and requiring a replacement bathroom and kitchen. He considered these differences would be likely to have an effect on value of around £2,000 for a replacement bathroom, £4,000 for a replacement kitchen, and around £1,000 for replacement windows. He concluded that the once the effect on value of the differences in condition had been taken into account, the transaction was in line with the sale of No. 85 at £128,500.

75. It is helpful at this point also to consider the value of the extended leasehold interest in No. 85.

76. Before the FTT, Mr Evans suggested a long leasehold value of £160,850, by applying a relativity of 91.7% to his assumed short lease value of £147,500.

77. Mr McKeown relied upon the sale of No. 59, which he said was virtually identical to No. 85. However, the ground rent was different - £175 per annum, subject to 10 year rpi increases (which suggests also that the extension was not completed strictly in accordance with the 1993 Act since otherwise the ground rent would have been eliminated). He reflected this by capitalising the difference in ground rent of £55 at 5% to reduce the price by £1,000. In oral evidence, he said the appropriate reduction might be as much as £2,000. On this basis, the comparable would support a sale price of £150,000 at November 2012, or £171,461 at the valuation date (i.e. £150,000 x 105.46/92.26), but for a 99-year lease following what appears to have been a non-statutory extension.

78. The FTT did not favour Mr McKeown's approach. It considered that the adjustment of prices by reference to a Land Registry index was "not entirely reliable … particularly as the sum suggested is too high as the Respondent concedes £160,500". In passing, we note the unexplained inconsistency in the FTT's approach, since it relied upon Land Registry indices in calculating the average price of the short leasehold interest.

79. Faced with these two valuations, the FTT adopted a figure of £162,500 for the extended leasehold interest, but gave no explanation.

80. There is no evidence before us that relativity differs as between flats and maisonettes, other things being equal. Our findings in respect of No. 51 resulted in a relativity figure of about 81%.

81. If we make a deduction of 3.5% for Act rights from the sale price of £128,500, a value of around £124,000 is arrived at. But the agreed range of values before the FTT was much higher, £162,474 to £169,696. Allowing a 1% differential from the long leasehold value, a short leasehold figure of £124,000 would represent a relativity of about 73% - 76%. This relativity, coupled with the evidence of the sales of No. 33 and No. 55, suggests that a figure of £124,000 without Act rights is too low.

82. We are not persuaded that the difference between No. 85 and No. 87 can be solely explained by differences in condition, and in any event the evidence in this respect was very limited. Mr McKeown hadn't inspected No. 87 and couldn't properly speak to its condition. The adjusted figures produced by No. 33 and No. 55 show significantly higher values than £122,884 – in the order of £40,000 to £50,000 – but they carry a health warning as they depend on the use of an index over a three-year period.

83. Taking all of this evidence into account we consider that an appropriate value for the short leasehold interest in No. 85 at the valuation date is £140,000, or say £135,000 allowing 3.5% for Act rights.

84. In respect of the long leasehold interest, adopting a similar relativity figure to that of No. 51 at about 81%, suggests a notional freehold value of say £167,200. We therefore determine the value of a long leasehold interest, after a deduction of 1%, to be say £165,500.

Conclusion

85. The Tribunal's valuations are attached as an appendix. We should add that there were some errors in the valuation presented to the FTT by Mr McKeown, which the FTT appears to have replicated, and which we have corrected. Mr McKeown's valuation assumed that the rent reviews in the 99-year leases were at equal 33 year periods. In fact, in each lease the first review was on 24 June 2016 – 31 years after the term commenced. The second review was 33 years later, leaving the final rental period to span 35 years. Accordingly, in respect of No. 51,

at the valuation date of 9 November 2015 there were 0.62 years to the fixed rent increase in 24 June 2016, not 2.68 years as Mr McKeown and the FTT calculated. Similarly, in respect of No. 85 at the valuation date of 23 October 2015 there were 0.67 years to the fixed rent increase, not 2.67 years.

86. The FTT made a further mathematical error. In the first part of its calculation, instead of calculating the diminution in the value of the freeholder's interest by deducting the value of the proposed interest from that of the present interest, the FTT actually aggregated the two, and then added 50% of the marriage value to this. Even on the FTT's figures, this would have the effect of overstating the premium.

87. The appeals are allowed in part, and we determine the premiums payable shall be as follows:

51 Humphrey Middlemore Drive: £13,136

85 Humphrey Middlemore Drive: £18,545

Martin Rodger QC
Deputy Chamber President

Peter D McCrea FRICS

27 July 2017

Appendix – Tribunal's Valuations

51 Humphrey Middlemore Drive

1. Diminution in freeholder's interest

(i) Value of existing freehold interest:

Present rent:				£45	pa	
yp	0.62	yrs @	5.50%	0.5936		£27
Reversion to:				£90	pa	
yp	33	yrs @	5.50%	15.075		
pv £1	0.62	yrs @	5.50%	0.9673		£1,312
Reversion to:				£180	pa	
yp	35	yrs @	5.50%	15.390		
pv £1	33.62	yrs @	5.50%	0.1652		£458
Reversion to:				£118,200		
pv £1	68.62	yrs @	5.50%	0.0253		£2,999
						£4,796

(ii) Value of proposed freehold interest:

Reversion to:				£118,200	
pv £1	158.62	yrs @	5.50%	0.0002	£24

Diminution in freehold value: £4,772

2. Marriage Value:

(i) Value of the proposed interests

Freehold:	£24	
Leasehold:	£117,000	
		£117,024

(ii) Value of present interests

Freehold:	£4,796	
Leasehold:	£95,500	
		£100,296

Marriage Value: £16,728

Freeholder's share @ 50% £8,364

Premium: £13,136

85 Humphrey Middlemore Drive

1. Diminution in freeholder's interest

(i) Value of existing freehold interest:

Present rent				£60	
yp	0.67	yrs @	5.50%	0.6406	£38
Reversion to:				£120	
yp	33	yrs @	5.50%	15.075	
pv £1	0.67	yrs @	5.50%	0.9647	£1,745
Reversion to:				£240	
yp	35	yrs @	5.50%	15.39	
pv £1	33.67	yrs @	5.50%	0.1648	£608
Reversion to:				£167,200	
pv £1	68.67	yrs @	5.50%	0.0253	£4,231
					£6,624

(ii) Value of proposed freehold interest:

Reversion to:				£167,200	
pv £1	158.67	yrs @	5.50%	0.0002	£34

Diminution in freehold value: £6,590

2. Marriage Value:

(i) Value of the proposed interests

Freehold:	£34	
Leasehold:	£165,500	
		£165,534

(ii) Value of present interests

Freehold:	£6,624	
Leasehold:	£135,000	
		£141,624

Marriage Value: £23,910

Freeholder's share @ 50% £11,955

Premium: £18,545