RECENT CASES AND POSSIBLE REFORMS

Answers by Laurence Nesbitt to questions set out in the presentation prepared by Ellodie Gibbons.

Law Commission's Terms of Reference

(1) I suggest changes to the procedure for tenants serving a notice of claim under Section 42. This presently seems quite torturous as there still seems to be several pitfalls for the tenant or their solicitor to be wary of. I see no reason for the requirement for the tenant to have owned the lease for a period of more than 2 years. This in any event is often circumvented by the claimant by serving the notice and then assigning the benefit.

(2) Generally I do not see how the premium (price) payable can be reduced without ensuring sufficient compensation to the landlord. However, there is one area where reforms can be made which is where intermediate landlords exist. It seems unfair that the premium payable by the tenant increases according to the number of landlords present. Significantly higher compensation has been awarded following the case in *Nailrile* due to the continued commitment for the intermediate landlord to meet its rental obligations following the grant of the new lease. Perhaps there should be provisions for head rent to be reduced following the grant of the statutory new lease.

(3) The leaseholder is in a position to shop around for the most cost effective advice available for both the legal and valuation work involved. However, he is also obliged to meet certain landlords costs which I believe in principle is correct. However, at the moment the system for ensuring that such costs are reasonable requires an application to the tribunal. As an alternative there may be a method of capping landlords' costs so that tenants would be fully aware of their maximum liability for the costs prior to making a claim. The amount by which these costs may be capped would be for further consideration by practitioners who are regularly involved with this work. Alternatively a scale system of fees may be appropriate so that fees remain in proportion to the size of the claim.

(4) We currently have a clear valuation methodology for assessing the premium (price). The current method allows for both the Landlord and Tenant to engage a qualified valuation surveyor who is ideally a specialist in Leasehold Reform valuations. As long as the charges are reasonable this provides both parties with the most reliable, accurate and fair valuation outcome. The system has been working for many year as proved by the sheer number of claims that are settled between the two valuation surveyors without recourse to a Tribunal. The questions raised in the paper are referenced to various Tribunal cases where certain issues were in dispute. This gives the impression that claims are having to be determined by a Tribunal on a frequent basis. This is definitely not the case. Statistical data is available from the First Tier Tribunal showing

the number of decisions in relation to the number of applications received. This is a very small percentage which reduces till further when one takes account of the number of claims made where no application (usually only protective) have been submitted to the Tribunal. Personally I have been settling every claim I have been instructed on over the last few years and I deal with hundreds of new lease and enfranchisement claims each year.

In essence the current system of valuation is working well and introducing any form of prescription would unnecessarily affect the accuracy and fairness of the compensation payable.

I deal with the various questions in the order set out in the paper as follows:-

***Clarise Properties Ltd v Rees* [2017] EWCA Civ 1135:**

1. There is a problem finding historic rateable values which are required to determine the basis of an enfranchisement claim. Since the intention of the original legislation was to exclude high value properties i.e. those falling above a certain rateable value limit, I would suggest that the rateable value limit is substituted by council tax bands. From my experience it is only the very highest value houses which fall outside section 9 (1) and I therefore suggest that any house falling within council tax band H in England (council tax band I in Wales) should be excluded from section 9 (1). If rateable values are to be dispensed with for this purpose there raises an issue as regards to whether the property meets the low rent test. It would therefore be necessary to scrap the low rent test for the purpose of determining whether a property falls within section 9 (1).

2. The post 1st April 1990 test is an alternative way of dispensing with relying on old rateable values. However, I question whether the premium payable on the grant of very old tenancies is reliable for the purpose of deciding whether a property falls within section 9 (1). I also question whether the amount of premium paid at the grant of the tenancy is actually known.

3. In essence the valuation methodology under section 9(1) in a majority of claims is not complicated. The issue that arose in Clarise Properties Ltd related to the unusual rent review provisions contained in their lease. I therefore do not suggest any changes to the methodology except in cases for problematic rent review provisions as raised in question 4 below.

4. In my view the issue of ambiguous rent review provisions is an area where steps may be taken to simplify the valuation. The decision in Clarise Properties gives guidance to valuers by determining that the methodology for assessing the open market letting value of the land is not the same as the approach for determining rents under section 15 of the 1967 Act. It was determined that the ground rents

should be the highest rent which a purchaser in the hypothetical market would be willing to acquire a lease of land. I do not necessarily agree with the decision but if we take it at face value this effectively means the rent is considered to be non-onerous. On this basis I suggest that the valuers task is to assess the capital value of the site and determine the ground rent based on 0.01% of that value.

5. I have to some extent covered this question under point 4 above. My favoured approach is to link the ground rent payable to capital value using 0.01%. If ground rents are to be reviewed I suggest these be based on known amounts at the outset in order to remove any uncertainty for the parties. I suggest ground rents should increase by the amount of the original commencing rent (as calculated at 0.01%) at 20 year intervals.

First Tier Tribunal (Property Chamber –v- Midland Freehold Ltd **[2017] UKUT 463 (LC)**

1. I do not see any reason to prescribed deferment rates. In my experience in a vast majority of enfranchisement claims this is not a point at issue. Prescribing the deferment rate will only serve as an unnecessary restriction on valuers who may come across situations where the prescribed rate is not applicable. This can act to the detriment of both the landlord and tenant. However as I have stated in a vast majority of claims deferment rate is not an issue and any peculiarities with the property under valuation is generally accounted for in the assessment of its capital value.

2. As shown in my answer to question 1, I am not in favour of prescribing deferment rates. One of my reasons is in fact that deferment rates may differ according to location.

3. In my experience relativity does vary geographically but it is difficult to generalise as to whether it varies between central London, outer London and between the various regions. More often I find that there are local factors that come into play in the value of short leases relative to long leases. I have dealt with blocks of flats where sales evidence has shown little difference in value between the short and long leases. I have also dealt with blocks of flats where there is a significant difference in the sales evidence between those with short and long leases. However I believe that this is a result of factors within the local market and does not show a pattern as to how relativity may vary across the country as a whole.

4. The market value of a residential property is reduced where it is subject to an assured tenancy at a market rent. Whether the value of the reversion is similarly affected depends on the likelihood of that assured tenancy being in existence by the time the lease reverts to the freeholder. However, under a statutory claim for a new lease it has to be considered that the tenant would not have an assured tenancy until the expiration of the existing lease. In my view it is unlikely that the tenant

would allow the lease to run down to the point where they would be required to pay a market rent. Further I doubt that any freeholder considers the prospect of the tenant holding over in his bid for a freehold reversion. Basically the bid is the same whether in the freeholders mind he has either the prospect of vacant possession or an assured tenant paying a market rent.

5. For reasons set out above I am of the view that the discount should be nil for any lease length.

Mundy –v- Trustees of the Sloane Stanley Estate **[2018] EWCA Civ 35.**

1. The current valuation assumptions have applied and have been working for almost 25 years. The *Mundy* case rejected the Parthenia model which is flawed and clearly produced the wrong values for the properties as held on the existing leases. I therefore do not see any reason to alter the valuation assumptions on the basis of one case where a flawed system of calculating relativity was applied.

2. This question is not particularly a valuation issue but rather a political issue. As a valuer I have no doubt that particularly for short leases significant marriage value arises upon merging the interests. How that marriage value is treated between the parties is more a question for the parties themselves. I would say however that Parliament originally enacted under the 1993 legislation that marriage value be shared (split 50/50 under the 2002 amendment) and perhaps that reasoning has to be considered before one may tamper with the issue now.

3. There is no argument that marriage value does not exist except in cases of very long leases.

4. I do not believe that there is any need to abolish the 80 year cut off since this would complicate the legislation and increase the premium (price) which the reforms are seeking to reduce. The amount of marriage value in cases where the lease has more than 80 years unexpired is fairly low and it is not worth the exercise. Further, the residential market has been working with the 80 year rule since 2002 and abolishing the cut off may have a detrimental effect on the market for leases over this length.

5. I can see no conceivable way of prescribing relativity. In a vast majority of cases valuers are effectively working to prescribe rates using graphs produced by various firms of valuers over the years. However there are many instances where the graphs are not the only tool available to the valuer in assessing the value of a short leasehold interest. For reasons set out above there are peculiarities in the market for leasehold flats and there are many other factors that may affect the value of a short leasehold interest relative to its extended leasehold value. More often than not these cases arise where there is convincing evidence of short lease transactions and which should not be ignored.

6. As stated above my firm view is that relativity should not be prescribed. The questions raised here really give weight to my view since it is impossible to determine who should prescribe it, how they should do it and how often. A number of firms who regularly carry out enfranchisement valuations have collated data and have produced graphs of relativity which have been helpful to the enfranchisement valuer. However no particular graph of relativity should necessarily be preferred over another and then cast in stone within new statutory provisions. As the value of a short lease relative to its extended lease can vary for locational and numerous other factors one graph could not possibly fit all. Further in my experience the value of shorter leases reduces in poor market conditions. Short lease values recover when the market recovers and this would not be reflected within a graph unless it is updated on a regular basis. It is therefore difficult to determine how regularly any prescribed graph should be updated to ensure it is not out of kilter with the market.

St Emmanuel House (Freehold) Ltd –v- Berkely Seventy-Six Ltd **CHI/21UC/OCE/2017/0025**

1. It should be possible to set capitalisation rates but this depends on whether the cash flow is treated on the same basis to other financial assets. The problem arises in that although the cash flow can be referenced to an index such as LIBOR there has to be an adjustment to take account of the risk or spread from the risk free rate. In my view once this has to be considered there is no point in setting the rate to an index.

2. For reasons given in 1. above I would leave it to the valuer to assess the value of the ground rent income.

3. This is a question that arises because of the decision in St Emmanuel House. However, tribunal decisions in regard to capitalisation rates are rare and in the main capitalisation rates actually form the least contentious area of valuation in this field. The decision gives some guidance to valuers dealing with blocks of flats where there is a significant income stream, but again these cases themselves are rare and I do not see the need to set rates.

4. I do not agree that there is a need to define particular classes of lease or property for the purpose of setting capitalisation rates.

5. It would appear to be that application of the rent charge formula would increase the costs significantly for tenants as compared to the general capitalisation rates currently applied by valuers. The rent charge formula was devised for generally low fixed rents. It would be difficult to apply in situations where the rent is increasing either at regular intervals or at certain lease events. In my experience a capitalisation rate of 6% is widely accepted for low ground rents. As an example a ground rent income of 20 years fixed for a 30 year term would give a capital value of £275.00. Applying the rent charge formula increases the capitalised value to £402.00.

Portman v Jameson **[2018] UK UT0027 (LC)**

1. I have not encountered the assumption for the disregard of tenants improvements to be problematic. The circumstances described in the case of Portman are rare and probably a one off. The idea that a tenant should not pay as part of the premium an amount that reflected improvements carried out at the cost of the tenant is sound and should be retained.

Francia Properties Ltd –v- St James House Freehold Ltd **[2018] UKUT 79 (LC)**

1. I have dealt with a number of cases where the freeholder has only sought to develop a property after a notice by the tenants has been served to claim the freehold. I believe a number of disputes can be avoided if there was a provision to exclude development value in the absence of a valid planning consent. If freehold owners of properties believe there may be potential to develop they must investigate this as part of their estate management practice and seek planning permission as a matter of course.

2. An overage agreement may apply in cases where a freeholder has proved development value (as a result of having a valid planning permission in place prior to the date of valuation).

3. In my experience when lessees of a block of flats seek to enfranchise they really prefer to have no further dealings or involvement with the freeholder. I therefore doubt that the imposition of a development lease following the transfer of the freehold is viable.

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