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RESIDENTIAL PROPERTY TRIBUNAL

LEASEHOLD VALUATION TRIBUNAL

Reference: LVT/0060/12/13

In the Matter of 12 Crofton Drive Baglan Port Talbot SA12 8UL

In the matter of an Application under Section 21(1)(cza) of the Leasehold Reform Act 1967

TRIBUNAL	David Evans LLB LLM Ruth Thomas MRICS
APPLICANTS	Mr Alun Llewellyn Thomas and Mrs Mair Thomas
RESPONDENTS	Unknown

DECISION

INTRODUCTION

1 We convened as a Leasehold Valuation Tribunal under the provisions of the Leasehold Reform Act 1967 (as amended)(the Act) on the 25th February 2014. We had before us an Order of the High Court dated the 18th November 2013 requiring Mr and Mrs Thomas (the Applicants) to apply to obtain from the Leasehold Valuation Tribunal a certificate of the appropriate purchase price of the freehold reversion of 12 Crofton Drive Baglan Port Talbot SA12 8UL (the Property).

BACKGROUND

2 The Applicants are the leasehold proprietors of the Property and wish to acquire the freehold reversion pursuant to the Act. After enquiries made on the Applicants' behalf the freeholder of the Property cannot be found. On the 17th September 2013, the Applicants made an application to the Chancery Division of the High Court claiming the right to purchase the freehold and on the 18th November 2013, the Court made the order referred to above.

LEASE

3 The lease of the Property (the Lease) is dated the 3rd July 1964. It was made between Frederick Phillips (1) Webb & Beer Ltd (2) and Jeffrey Hawes (3). It is for a term of 99 years from the 25th December 1963 at a yearly ground rent of fifteen pounds (£15.00) payable quarterly. The Lease contains the usual requirements for the lessee to pay the outgoings, insure the Property and maintain it. The lessee was also required to complete the construction of the dwelling.

INSPECTION

4 Prior to hearing the application, we inspected the Property internally and externally. We were accompanied on our visit by Mrs Grant, the owner of the adjoining property. The Property is one of a pair of a semi-detached two story dormer bungalows of traditional cavity brick/blockwork

construction, typical of the period of the early 1960s. The roof, with its steep pitch, is clad in concrete interlocking tiles and incorporates the first floor accommodation. The dormer windows are of timber frame and clad with felt, mock tiles on the elevations and with felt or fibreglass flat roof. Internally, the Property has an entrance hall, bathroom, living/dining room and kitchen on the ground floor and three bedrooms on the first floor. The leaseholders have carried out the usual repairs and modernisations such as replacement upvc windows, plastic guttering, installation of modern boilers and upgrades to kitchens and bathrooms. The property occupies a steeply sloping site downwards from road level to the rear. This means that the vehicular access onto the site is compromised to the extent that it is unlikely you could safely drive a modern vehicle onto the plot. There is no garage. Beyond the rear boundary is an undeveloped area of woodland which slopes away. Although the property is in an elevated position there is quite a lot of road noise from the nearby M4 and other A class roads and any views are partially obstructed by the trees.
The property has not been extended.

5 We also took the opportunity to view the following properties from the kerbside prior to the hearing. The first four were mentioned in a valuation report prepared by Mr Ieuan Jones FRICS FCIArb. The Tribunal disclosed that it was aware of the last comparable which was completed shortly after the date when proceedings were issued.

53 Dol Las - a slightly larger three-bedroom semi-detached house, probably with a first-floor bathroom. The property has a conservatory and garage with rear access. It was sold freehold in May 2013 for £120,000.

19 Lodge Drive - a larger, slightly older and more established style semi-detached house with a rear extension, drive and garage which was sold in September 2013 for £130,000.

96 Maes Tŷ Canol - a similar size three-bedroom semi-detached house with a level plot and off-road parking, sold March 2013 for £124,500.

64 Maes Tŷ Canol - similar to the previous property both in size and style, a three-bedroom semi-detached house but in inferior condition, sold July 2013 for £115,000.

13 Maes Tŷ Canol - a three-bedroom semi-detached dormer bungalow with a first-floor bathroom and garage on a smaller plot at a busy road junction. The position and size of this plot rendered this property less attractive. It sold in October 2013 for £115,000.

HEARING

6 The hearing took place at the Baglan Community Centre, Baglan on the 25th February 2014. Mrs Grant, the owner of no 13 Crofton Drive, was present and the Applicants were represented by Mr Jones. Mr Jones presented his report in which he had followed what is generally referred to as the Haresign approach (named after the Lands Tribunal's decision in Haresign –v- St John the Baptist's College Oxford (1980) 255 EG 711): firstly capitalising the current ground rent for the remainder of the term; secondly ascertaining a modern ground rent for the Property, capitalising that modern ground rent for 50 years and deferring the result to the end of the current term; and thirdly calculating the standing house value of the Property 50 years beyond the end of the current term. The value of the reversion was the sum of these three calculations. In doing so he had followed the decision of the Upper Tribunal in Clarise Properties Limited [2012] UKUT 4(LC)(the President and Mr N J Rose FRICS) (Clarise).

7 However, Mr Jones adopted the rate of 4.75%, the "generic" rate put forward in Cadogan – v- Sportelli [2007]1EGLR 153 (subsequently confirmed in the Court of Appeal)(Sportelli) for each stage of the calculation. He told us that until recently, he and his colleagues in his organisation had been using 5.5% or 5.25% for capitalisation of the ground rent, but in November 2013, there had been a decision of the First Tier Tribunal in Newcastle and since that, they had been using 4.75% for each stage. He was unable to tell us the name of the case. His firm had been involved in that case, although he had not been involved personally.

8 We pointed out to Mr Jones that the Lands Tribunal specifically stated in Sportelli that "nothing that is said in this decision has any direct application to capitalisation rates". In the case of Sir Charles Christian Nicholson Bt, Sir Michael Bunbury Bt KCVO and William George Wilks (LRA/29/2006), the Lands Tribunal approved (at paragraph 10) certain issues as being relevant when determining the capitalisation rate to be applied when valuing the ground rent: the length of the lease unexpired, the security of recovery, the size of the ground rent and the period and nature of any review. Clearly, the less attractive the proposition, the higher the rate of return required by an investor. An investor purchasing the asset will bear in mind that the gross return is only £15.00 pa and that there are administrative costs associated with the collection of the ground rent which will need to be factored in. We suggested to Mr Jones that a figure of 6½ % might be more appropriate and in keeping with other decisions of this Tribunal. Mr Jones was happy to agree.

9 Mr Jones did not have any evidence of plot sales. He felt in the wider area there may be some backland or more substantial plots but no infill plots comparable with these dwellings. He had therefore adopted the standing house method, an approach which involves ascertaining the value of the Property on the basis that it is good condition and fully develops the site. He placed a value on the Property of £120,000. He referred us to the comparables mentioned above (except for 13 Maes Tŷ Canol, which we raised). Mr Jones said that in applying the comparables to his valuation, he had taken a general view of the area, bearing in mind that the biggest effect on sale prices locally was the stamp duty threshold of £125,000. He felt this effectively capped the prices achievable. He told us that the comparable at Lodge Drive at £130,000 was an exception due to the type of house and its additions. He also said that generally the location of a ground or first-floor bathroom had little effect on price but the addition of a garage would affect purchaser's perceptions, though it might not add value if the garage were at the bottom of the garden. Conservatories are a selling point, although they will usually cost more than the additional value. In this case, he felt that the plots of both 12 and 13 Crofton Drive were compromised as a result of the difficult vehicular access.

10 No. 13 Crofton Drive is currently being marketed at £127,250. This reflected an assumption that the freehold was available to the new purchaser. Mrs Grant confirmed that she had asked the agents to market at this price to allow for negotiation. She agreed with Mr Jones' comments regarding the effect of the stamp duty threshold. Mr Jones had not used the figure of £127,250 in his valuation as he had taken a broader view of the area and the comparables available and disregarded the individual presentation and improvements of the property.

11 In order to ascertain the value of the plot Mr Jones had adopted a proportion of 30% of the entirety value of the dwelling which produced a value for the plot of £36,000. 30% was a percentage in general use, although if the plot was out of proportion he might apply a different percentage. He would apply the same percentage for a terraced house but might use a different percentage for a small bungalow on a large plot. However, he considered that £36,000 was far too high to represent a likely sale price for a plot in this area. There would be little demand as in his experience there were significant problems with mortgageability for self-build dwellings. There were more repossessions for self-built houses in South Wales than anywhere else. The bigger lenders were placing restrictions on mortgages for this kind of property. A plot of land available to build a pair of houses, in this locality, might be sold for approximately £40-£45,000. Mr Jones would not pay more than £20,000 for the plot.

12 Mr Jones told us that he had been using 5% to decapitalise the plot value in order to ascertain the Section 15 ground rent or modern ground rent as it is generally called. This is the rate applied generally in Wales. However, since the case in Newcastle to which he had referred earlier, this had changed to 4.75%. Now he used 4.75% and his colleagues used the same rate throughout the UK even in central London. All settlements are at that rate. However, he had no objection to the Tribunal using 5%.

13 He did not see any difference between the entirety value and the standing house value. Although number 13 is on the market for £127,250, Mrs Grant told us that it will not achieve more than £125,000, probably somewhere between £120,000 and £125,000. According to Mr Jones,

whilst there has been more activity in the housing market in the last 2 or 3 years, - though nothing like at its peak - the effect has been to "bunch" prices closer to the stamp duty threshold.

14 Mr Jones had not considered the effect of Schedule 10 of the Local Government and Housing Act 1989 in his valuation report.

CONSIDERATION

15 Section 9(1) of the Act states that our role is to determine "the amount which at the relevant time the house and premises, if sold in the open market by a willing seller (with the tenant and members of his family…not buying or seeking to buy) might be expected to realise…" We are required to make certain assumptions one of which is that the Property is being sold freehold but subject to the lease which, if it has not already been extended, has been extended. In other words the assumed term expires 50 years after the contractual term date. Here, the contractual term ends in 2062 so that the assumed date when the lease will expire is in December 2112.

16 In the past, it has been accepted that the two stage approach would generally be used where there were, say, over 50 years to run on the lease so that the deemed expiry date was over 100 years into the future. As in this case there were only 49.25 years from the valuation date to the end of the term, it was always possible that the market would adopt the three stage Haresign approach when valuing the reversion. That must be the case where the three stage valuation is significantly higher than the two stage valuation. This is the approach adopted by Mr Jones.

17 Further, there is no suggestion that the house will not still be standing and in good condition at that time provided it is properly maintained. We accept that there is no guarantee that in the future it will be maintained as it has been to date, but in the absence of any evidence to suggest otherwise, we conclude that it is appropriate to adopt the three stage approach as used in Clarise to determine the value of the freehold reversion.

DETERMINATION

Date of Valuation

18 We have considered our decision on the basis that the valuation date is the 17th September 2013 being the date when the application was made to the Court. The lease is for 99 years from the 25th December 1963 which means therefore there were approximately 49¼ years unexpired.

Capitalisation Rate

19 Mr Jones accepted that a capitalisation rate for the ground rent of 6½% would be more appropriate than the 4.75% expressed in his report. As referred to above, an investor purchasing the asset will bear in mind that the return of £15.00 is not substantial and there are administrative costs associated with the collection of the ground rent which will need to be factored in. In our view, a figure of 6½% is not unreasonable and in keeping with other decisions of this Tribunal. This produces a value for the unexpired term of £220.39.

Entirety Value of the Property

20 Although we are acquainted with the cost of development land as well as single plots, we had no comparable evidence of land values relating to properties of this nature in Baglan or the Port Talbot area. We agree therefore that it is appropriate to calculate the modern ground rent by the "Standing House" method. In his report Mr Jones considered the entirety value of the Property to be £120,000 on the basis of the comparable properties referred to above. Whilst we note that the adjoining property is on the market for £127,250, we accept that this allows room for negotiation.

Leaving aside the more substantial 19 Lodge Drive (£130,000), the prices of properties in the area were between £115,000 and £124,500. 96 Maes Tŷ Canol at £124,500 is on a level plot and with more accessible off street parking. Applying our knowledge and experience, we agree with Mr Jones that the entirety value of the Property on the basis that the house was modernised, in good condition and fully developed the site was £120,000 as at the valuation date.

Plot Value

21 In his report, Mr Jones suggested a plot value of 30% of the standing house value although he did not consider that this percentage produced a realistic valuation for the plot. We must take into account the dimensions, nature and location of the site, particularly the significant slope down from the access road, the short plot and the inevitable building constraints as well as the additional costs involved in building there. We accept Mr Jones' evidence that £36,000 is more than would be achieved in the open market. In such circumstances it is proper that we should consider a lower percentage. Mr Jones suggested that he would not pay more than £20,000 for a single plot and that someone might pay £40,000 to £45,000 for a double plot. We consider that for a serviced site his figures are just a little below what could be achieved on the open market. In our view 20% is the appropriate proportion of the standing house value attributable to the plot. We therefore determine the plot value to be £24,000.

Decapitalisation

22 Mr Jones applied a rate of 4¾% to decapitalise the plot value to ascertain the modern ground rent. He provided no evidence to support that rate, relying on its being the generic rate in accordance with the Sportelli guidelines and a First Tier Tribunal Property Chamber case in Newcastle. The rate must always be a question of fact and depend on the circumstances of the case. We suggested to Mr Jones that a rate of 5% was more in line with other decisions of this Tribunal and he accepted this. In our view 5% produces a fair assessment of the modern ground rent attainable for the Property. Current rates of return in the market are currently at a low level and may remain low for a year or so longer, but they will not always remain this low. We have to bear in mind that the modern ground rent is fixed for 25 years and an investor would not wish to have a rate fixed at that low a level for such a long period of time.

23 We appreciate that in Clarise the Upper Tribunal endorsed a rate of 5½%. This was the rate which the parties had agreed should apply to the deferment rate before the Leasehold Valuation Tribunal. The Upper Tribunal appears to be suggesting that the deferment rate determines all three rates - decapitalisation, recapitalisation as well as deferment. In our view, the process of decapitalisation – which can be independent of the acquisition of a freehold reversion – is fundamentally different from the deferment exercise. The former is establishing a return on an investment, the latter the price someone would be prepared today for an asset which will not be in the buyer's possession for 99 years. The effect of decapitalising site values by applying deferment rates could be that two identical properties are assessed as having different modern ground rents simply because one is a basic modern ground rent calculation and the other is part of a freehold purchase. This does not seem to have been considered by the Upper Tribunal in Clarise. We conclude that notwithstanding the guidance in Clarise, and in line with other decisions of this Tribunal, the appropriate rate for decapitalisation is 5%.

Recapitalisation

24 In order to avoid what is sometimes referred to as an adverse differential the same rate must be used for decapitalisation, i.e. to ascertain the modern ground rent, and to recapitalise the modern ground rent before deferring it. (See Lord Denning MR in Official Custodian for Charities

and Others –v- Goldridge (1973 26 P & CR 191): "They should adopt the same percentage for re-capitalisation as for decapitalisation. This is a better way of finding 'fair terms'"). Using a different rate for recapitalisation produces an unfair advantage to one side or the other. We therefore adopt the same rate for recapitalisation as decapitalisation, namely 5%.

Deferment

25 For many years Tribunals deferred at a different rate from that used for decapitalisation and recapitalisation as this was a different step in the process and different considerations might apply. In Clarise the Upper Tribunal used the Sportelli deferment rate of 4¾% as its starting point. However, it accepted the argument that the prospects for capital growth were lower in the West Midlands than in Prime Central London (PCL) and increased the rate by ½% to 5¼%. It then added a further ¼% to the deferment rate because the reversion was to a house and to allow for the possibility of greater deterioration relative to value for properties outside PCL. It considered that the cost of repairing a house outside PCL was relative to value more expensive than the cost of repairing a house within PCL.

26 Whilst we consider it correct to add the ¼% to the basic Sportelli rate of 4¾% to account for the deterioration factor, in the absence of evidence relating to the growth factor, we are unable to justify adding a further ½%. We therefore apply a deferment rate of 5%. This has the effect of valuing what is sometimes referred to as the first reversion at £1981.58.

Standing House Value

27 The final stage in the valuation process is to determine the value of the Property and defer that figure for the period of the contractual term plus the deemed 50 year extension as prescribed by the Act. For this we use the value of the Property in its existing form as at the valuation date. The entirety value is based upon the assumption that the Property is in good repair and condition and fully develops the site. In our view, it is in such condition now and was no doubt in September 2013. Whilst it is arguable that number 13 next door, on the market at £127,250, is in better decorative order, we do not consider that this will materially affect the valuation as some purchasers like to add their own finishing touches to a property. We do not consider that there would have been any significant difference between the entirety value and the standing house value. We therefore determine that the standing house value is £120,000.

Schedule 10 of the Local Government and Housing Act 1989 (Schedule 10)

28 In Clarise, the Upper Tribunal dealt with the assumption that Schedule 10 of the Local Government and Housing Act 1989 (the 1989 Act) might apply to the tenancy created by the lease. Under the 1989 Act, the original tenancy automatically continues until notice is served under paragraph 4 of Schedule 10. The lessee is then entitled to an assured tenancy under the Housing Act 1988 at a market rent. The reversioner will therefore not be certain that it will obtain possession. The Upper Tribunal held that that uncertainty would have a depressing effect upon the value of that reversion. In Clarise, it reduced the standing house value (not the same as the entirety value used for ascertaining the plot value) by 20%.

29 The Upper Tribunal commented that whilst "the purchaser of the freehold reversion would have no means of knowing whether vacant possession would be gained at the end of the 50 year lease extension"…"the fact that there can be no certainty of obtaining vacant possession would have a significant depressing effect on value…" Without the benefit of comparable evidence, the Upper Tribunal deducted 20% from the "full standing house value" of the Property.

30 This issue had been considered previously by the Lands Tribunal in Vignaud –v- Keepers and Governors of John Lyon's Free Grammar School (LRA/9 & 11/1994)(Vignaud) and by the Upper

Tribunal in Sillvote Ltd –v- Liverpool City Council [UKUT] 192 (LC) (Sillvote). In the former case, HH Judge Rich accepted a deduction of 10% to reflect "the remote risk that [the leaseholder] or some assignee in the last ten months of the term might" exercise the tenant's rights under Schedule 10 and remain in possession even though the Judge was "virtually certain" that the leaseholder would not exercise those rights. In his decision, HH Judge Rich stated that "the proper deduction for this right must be a matter of evidence or agreement". In Sillvote, where there were 11 years remaining on the lease, Mr P R Francis FRICS stated that the question was "whether, as a matter of evidence, there is a likelihood that the lessee will exercise that right". He held that there was no evidence and consequently made no deduction. Following that decision, in Cardiff County Council –v- The Estate of Alice Zelia David (3 Ovington Terrace, Cardiff)(reference QA 976565) this Tribunal also held that it had no evidence upon which to base a deduction from the house value to take account of the lessee's Schedule 10 rights. In Clarise, the Surveyor for the Appellant had suggested a nominal deduction to take account of the fact that these rights would only be exercisable at the end of the statutory 50 year lease extension – in Clarise, in 78½ years' time. However, the Upper Tribunal made its 20% deduction on the assumption that the deduction had to be significant.

31 In this case, the extended lease term ends 99¼ years after the valuation date, a longer period than that in Clarise and substantially longer than Vignaud and Sillvote. We acknowledge the Upper Tribunal's guidance and therefore we conclude that a significant deduction needs to be made from the standing house value in order to take account of the lessee's Schedule 10 rights. The amount of such deduction is preferably to be based upon evidence, but, as with Clarise, we have none provided on behalf of the Applicants. We must therefore rely upon our knowledge and experience. The value of the Schedule 10 rights is essentially a question of judgment. We do not consider that the market would factor in a deduction as high as 20% to take account of the possibility that a lessee might retain possession in 99¼ years' time with the benefit of an assured tenancy. In our judgment, we consider the appropriate deduction is 10% - significant enough to take account of the risk of those rights being exercised, but not such as to over compensate bearing in mind that these rights are only exercisable in 99¼ years' time and indeed may not be exercised at all. This produces an adjusted standing house value of £108,000.

32 Applying the same deferral rate of 5% as above to the standing house value, the second reversion is valued at £851.89 to which we add the capitalised current ground rent of £220.39 and the value of the first reversion of £1981.58 making a total of £3,053.86, say £3,050. We have set out the valuation below. If we had applied the above values and percentage rates to the two stage approach, the purchase price for the reversion would have been £2,391. In our view the difference is significant and therefore justifies the use of the Haresign approach.

DECISION

Valuation of the Freehold Reversion

33 Applying the above findings, we calculate the value of the freehold reversion of 12 Crofton Drive, Baglan, Port Talbot, SA12 8UL as follows:

Ground Rent	£15.00	
49¼ years purchase @ 6.5%	14.692596	£220.39

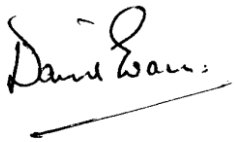
Entirety value	£120,000.00
Plot value @ 20%	£24,000.00
Modern Ground Rent @ 5%	£1,200.00

Yrs. Purchase 50 yrs @ 5%	18.255925	£21,907.11	
Present value of £1 in 49¼ years @ 5%		0.0905	£1,981.58
Standing house value	£120,000.00		
Less Schedule 10 rights @ 10%	£12,000.00		
Adjusted value	£108,000.00		
Present value of £1 in 99¼ years @ 5%	0.007888		£851.89
			£3,053.86
		Say	£3,050.00

Ground Rent Arrears

34 We respectfully draw the attention of the County Court to the provisions of Section 27(5)(b) of the Act, substituted by section 149 of the Commonhold and Leasehold Reform Act 2002, which requires the leaseholder to pay "the amount or estimated amount ....of any pecuniary rent payable for the house ...which remains unpaid". The amount so payable can only be the amount for which the freeholder can enforce payment. If it were otherwise, a leaseholder of an untraced freeholder would be required to pay more than a leaseholder whose freeholder's identity was known. We were informed that the last ground rent was paid in 2003. The maximum recoverable is £15.00 a year for the period of 6 years, namely £90.00. However, this was not an issue referred to us and so the actual amount of ground rent payable by the Applicants is a matter for the County Court.

Dated this 2nd day of April 2014



CADEIRYDD/CHAIRMAN