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RESIDENTIAL PROPERTY TRIBUNAL

LEASEHOLD VALUATION TRIBUNAL

LVT Ref: LVT/0031/10/14

TRIBUNAL D J Evans LLB LLM
R W Baynham FRICS

In the matter of 22 Mervyn Way, Pencoed, Bridgend, CF35 6JH
In the matter of an application under S.27 of the Leasehold Reform Act 1967

APPLICANT Mrs Tracy Finucane

RESPONDENT Kilmartin Properties Ltd

DECISION

Introduction

1 We convened as a Leasehold Valuation Tribunal under the provisions of the Leasehold Reform Act 1967 (as amended) on the 17th December 2014. We had before us an Order of the Bridgend County Court dated the 19th August 2014 requiring the Leasehold Valuation Tribunal to make a determination of the value of the freehold reversion of 22 Mervyn Way Pencoed Bridgend CF35 6JH (the Property).

Background

2 Mrs Tracy Finucane (the Applicant) is the leasehold proprietor of the Property and wishes to acquire the freehold pursuant to the Leasehold Reform Act 1967 (the Act). After enquiries made on the Applicant's behalf, the freeholder of the Property, Kilmartin Properties, cannot be found. On the 6th August 2014, the Applicant made an application to the Bridgend County Court claiming the right to purchase the freehold under the Act and on the 25th September 2014, the Court ordered that the valuation of the Property be referred to this Tribunal.

Lease

3 The lease of the Property (the Lease) is dated the 5th November 1976. It was made between Tayloc Developments (Glamorgan) Ltd (1) and John Lewis and Elaine Crabtree (2). The Lease is for the term of 99 years from the 25th December 1975 at a yearly ground rent of £22 payable half yearly. The lease is in a standard form for leases of that era requiring the lessee to pay the outgoings, insure the Property and maintain it. The lessee also has the right to park in a communal parking area nearby.

Inspection

4 Prior to considering the valuation of the freehold reversion, we inspected the Property internally and externally. We were accompanied on our visit by the

Applicant. The Property is a mid-terrace house constructed in about 1976. It is brick built with a tiled roof. The houses in the terrace do not stand side by side but are staggered so that one half of the house is overlapped by half of one adjoining property and in turn overlaps half of the other adjoining property. According to the title, the front garden is the width of the right hand half of the house whilst the back garden extends from the left hand side of the back of the house and then widens cutting across the back garden of the left hand neighbouring property, thereby doubling the width of the garden which then narrows gradually to its original width. This gives the plot a reasonable sized if somewhat unusually shaped garden.

5 The Property is located in a quiet cul-de-sac, set back from the road and approached through a gap in a communal wall and by means of a footpath. At the rear of the Property is a wooded area. There is no rear lane access. Close by is the communal parking area. The car parking spaces are not designated. There is no parking facility either at the front or rear of the Property.

6 Internally, there is a small entrance hall, a living room and a kitchen containing units and a cupboard. The stairs lead from the living room to the landing. There are two bedrooms and a bathroom with a wash hand basin, toilet and shower. The Property is double glazed and centrally heated. Adjacent to the living room is a substantial, tiled, glass conservatory added by a previous lessee through which access is gained to the garden.

Representations

7 The Applicant's Solicitors had agreed that we should determine the case on the papers without a hearing. They submitted a report, dated the 12th November 2014, by Mr Howard J Evans FRICS of Apex Surveyors Ltd Pontypridd for our consideration. Mr Evans has adopted the "standing house" method in order to ascertain the value of the plot on which the house stands. This involves valuing the Property on a freehold basis, assuming it to be in good condition and fully developing the plot. This is sometimes referred to as "the entirety value". He values the Property on that basis at £105,000.

8 Mr Evans refers to a number of comparable properties in support of his valuation. He has also helpfully annexed particulars of those properties. Following our inspection of the Property, we made external inspections of all but one of the properties. From Mr Evans' narrative and from the details provided, we did not consider that 41 Eleanor Close Pencoed, a relatively modern three bedroomed, semi-detached house which sold in 2009 for £130,000 would provide much assistance.

The properties inspected were:

- 1 Erw Ifan, Pencoed - a three bedroom, semi-detached house with an additional sitting room. According to Mr Evans, it is not in as good a condition as the Property. It sold in October 2014 for £92,000.

- 80 and 98 Maes y Haf, Pencoed - two bedroom properties situated some distance from the Property on an attractive, modern, well laid out estate close to the M4. Both have front and rear gardens and off street parking. No 80 appeared well located whilst no 98 backed on to the motorway. No 80 sold in October 2014 for £105,000 and no 98 was stated to be under offer at the same price.

- 37 Heol Las, Pencoed - a traditional three bedroom semi-detached house with three reception rooms and good sized gardens. It is reported to be under offer at £110,000.

9 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 by 50 years. In other words the assumed term expires 50 years after the contractual term date. Here, the contractual term ends in 2074 so that the assumed date when the lease will expire is in December 2124.

10 In the past, it has been accepted that, what is sometimes called, 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. This involves ascertaining a modern ground rent for the Property (or, as it is more properly called, a section 15 ground rent), recapitalising that section 15 ground rent in perpetuity, and deferring that value to the end of the current term. Nonetheless, it was always considered more likely that the market would adopt the "three stage" approach or, as it is often called, the Haresign approach (named after the Lands Tribunal's decision in Haresign –v- St John the Baptist's College Oxford (1980) 255 EG 711), where that approach produced a value significantly higher than that achieved by the two stage approach . In the "three stage" approach, the section 15 ground rent is capitalised only for 50 years, deferring the result to the end of the current term. The added third stage is to calculate the standing house value of the Property and defer that value 50 years beyond the end of the current term.

11 Mr Evans has employed the "two stage" approach in order to calculate his valuation. In doing so, he has chosen not to follow the decision of the Upper Tribunal in Clarise Properties Limited [2012] UKUT 4(LC)(Clarise). Clarise advocated the use of the "three stage" approach "where the reversion does have a significant value. In future, therefore , we consider that the appropriate approach will be to capitalise the section 15 ground rent to the end of the 50 year extension and to assess the value (if any) of the ultimate reversion". Furthermore, there is no suggestion that the house will not still be standing 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.

Consideration

12 Date of Valuation

We have considered our Decision on the basis that the valuation date is the 6th August 2014 being the date when the application was made to the Court. The lease is for 99 years from the 25th December 1975 which means therefore there were approximately 60 years and 5 months unexpired.

13 Capitalisation Rate

Mr Evans has used a capitalisation rate for the ground rent of 6½ %. An investor purchasing the asset will bear in mind that the return of £22 is relatively small 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 appropriate and in keeping with other decisions of this Tribunal. This produces a figure of £330.92.

14 Value of the Property

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. We have therefore adopted Mr Evans' approach and proceeded by way of the "Standing House" method. In doing so, we have taken into account Mr Evans' valuation report to which we have applied our knowledge and experience of the market in the area. Of the 5 properties to which he refers, the sales of the two properties in Maes y Haf appear to us to be the most relevant. Both are two bedroom properties and whilst no 98 has the disadvantage of backing on to the M4, they are both fully modernised, on an attractively laid out development and have the benefit of off-street parking. The estate is closer to Bridgend with its amenities and bus and rail connections as well as being well positioned for access to the M4. The Property is, of course, on a good sized plot and has a conservatory. Mr Evans considers that these would have the effect of placing its value at the same level as the Maes y Haf properties. With respect, we do not agree. The plot, though of a reasonable size, is awkwardly shaped. The house itself has an unusual configuration which might not appeal to as many purchasers and conservatories do not necessarily add that much extra to the value of the house to which it is attached. We consider that on balance, the Maes y Haf properties, particularly number 80, would achieve a slightly higher price on the open market. In our view, the entirety value of the Property is £102,000 as at the valuation date.

15 Plot Value

Mr Evans suggests a plot value of 30% of the standing house value. In our view this is appropriate. Although the configuration of the house is unusual and the unusual shape of the plot might present some difficulty in the construction, these difficulties will be reflected in the ultimate value of the completed house. To reduce the value of the plot as a percentage of the value of the Property would in this case represent a double discount. We determine the site value percentage to be 30%. The plot value is therefore £30,600.

16 Decapitalisation Rate

Mr Evans applies a rate of 5% for decapitalisation, the process to ascertain the section 15 rent, on the basis that it has been used by this Tribunal in an earlier case. We agree with Mr Evans that applying a rate of 5% is appropriate. Returns in the market are currently at a low level, although they may not always remain this low. They are affected by economic conditions and landlords are still accepting lower rents in order to keep premises tenanted. The section 15 ground rent would be fixed for 25 years, which is why the rate is bound to be higher than "high street" rates advertised by banks and building societies. Using our own knowledge and experience, we therefore consider that the appropriate decapitalisation rate is 5%, namely £1,530 pa.

17 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 many years. 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

18 In order to avoid what is sometimes referred to as an adverse differential, the same rate as was used for decapitalisation, i.e. to ascertain the section 15 ground rent, must be used 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

19 Mr Evans applies the deferment rate put forward in Cadogan –v- Sportelli [2007]1EGLR 153 (subsequently confirmed on appeal) as adapted in Mansal Securities Ltd (LRA/185/2007)(Mansal), namely 5%. However, in Mansal, the Lands Tribunal (as it then was), increased the Sportelli rate by ¼% to compensate for the increased volatility and illiquidity because the reversion was to a site only and not to a house. That is not the case when applying the "three stage" approach.

20 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. In Sinclair Gardens Investments (Kensington) Ltd [2014]UKUT 0079, the Upper Tribunal (Martin Rodger QC and A J Trott FRICS) emphasised the importance of relating the additional ¼% to the "characteristics of the property in question". In this case, the unusual configuration, the full width conservatory which inhibits access to maintenance at the back of the Property and the lack of rear access will impede maintenance and these, together with the lack of any competent regime for managing the common areas, are in our view likely to cause an investor to perceive a greater risk of deterioration and obsolescence than already accommodated in the Sportelli risk premium or reflected in the freehold vacant possession value.

21 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 agree with Mr Evans, for different reasons, and apply a deferment rate of 5%. This has

the effect of valuing what is sometimes referred to as the first reversion at £1466.01.

Standing House Value

22 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 August 2014. 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 £102,000.

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

23 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%.

24 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.

25 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.

26 In this case, the extended lease term ends 110 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 110 years' time with the benefit of an assured tenancy. In our judgment, we consider the appropriate deduction is 5% - 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 110 years' time and indeed may not be exercised at all. This produces an adjusted standing house value of £96,900.

27 Applying the same deferral rate of 5% as above to the standing house value, the second reversion is valued at £443.22 to which we add the capitalised current ground rent of £330.92 and the value of the first reversion of £1466.01 making a total of £2240.15, say £2240. 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 £1936.59. In our view the difference (over 15%) is significant and therefore justifies the use of the Haresign approach.

DECISION

28 Freehold Valuation

Applying the findings that we have made above, we calculate the value of the freehold of 22 Mervyn Way Pencoed CF35 6JH as follows:

	£	£	£
Ground Rent	22.00		
60.42 years purchase @ 6.5%		15.042	330.92
Entirety value			102,000.00
Plot value @30%			30,600.00
Modern Ground Rent @ 5%			1,530.00
Years purchase for 50 years @ 5%	18.2559		
PV of £1 in 60.42 years @ 5%	0.05245	0.957522	1,466.01
Standing house value	102,000.00		
Less Schedule 10 rights @ 5%	5,100.00		
Adjusted value			96,900.00
PV of £1 in 110.42 years @ 5%	0.004574		443.22
			2,240.15
Say			2,240.00

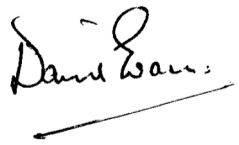
29 Ground Rent Arrears

Section 27(5)(b) of the Leasehold Reform Act 1967, substituted by section 149 of the Commonhold and Leasehold Reform Act 2002, 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, namely 6 years. According to a statement from the Applicant's Solicitors, the last ground rent demanded was prior to the date when the Applicant acquired the Property in 2007. We conclude therefore that the maximum recoverable is £22 a year for the period of 6 years, namely £132. However, we have only been asked to determine the value of the freehold reversion. We therefore refer back to the County Court the question of any ground rent arrears.

SUMMARY

30 We determine the value of the freehold reversion of 22 Mervyn Way, Pencoed pursuant to the Order of the Bridgend County Court dated the 25th September 2014 to be £2,240.

Dated this 7th day of January 2015



Chairman