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Property
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Case reference: PJ/LON/00BK/OCE/2010/0024

**DECISION OF THE LONDON LEASEHOLD VALUATION TRIBUNAL ON
AN APPLICATION UNDER SECTION 24 OF THE LEASEHOLD REFORM,
HOUSING AND URBAN DEVELOPMENT ACT 1993
(DEFERMENT RATES)**

Property: 82 Portland Place, London W1

Applicant: Howard de Walden Estates Limited

Respondent: 82 Portland Place (Freehold) Limited

Date heard: 11, 12, 13, and 14 October 2010
with subsequent written representations

Appearances: Michael Pryor, counsel, instructed by Speechly
Bircham LLP, solicitors, for the applicant

Stephen Jourdan QC and Catherine Taskis,
counsel, instructed by TLT LLP, solicitors,
for the respondent and for the intermediate
landlord

Tribunal: Margaret Wilson
Raymond Humphrys FRICS

Date of decision: 23 May 2011

Introduction

1. This decision is made on an application under section 24 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the Act") to determine the terms of acquisition of 82 Portland Place, London W1. The present decision relates only to the deferment rates to be applied to the landlord's interests, other aspects of the dispute having been determined after an oral hearing by our decision dated 24 November 2010. Although expert evidence was given at the hearing as to the deferment rates to be applied, it was agreed at the end of the hearing that the decision as to deferment rates should be postponed pending the decision of the Upper Tribunal (Lands Chamber) in *Erkman and others v The Earl Cadogan*, and that after that decision was issued the parties would make written submissions as to the deferment rates to be applied in the light of that decision and of the evidence given at the hearing. The decision in *Erkman* has now been issued ([2010] UKUT 427) and the parties have made further written submissions as agreed.

2. The factual background to the dispute which is the subject of the present decision is set out in our previous decision on issues other than deferment rates and will not be repeated here.

3. It is agreed that the issues which remain for determination are the deferment rates to be applied to the reversions to the short leases (ie those with 11.81 or 11.82 years unexpired at the valuation date, which is 11 September 2009) and to the long leases (ie those with 101.81 years unexpired at the valuation date). In our previous decision we said that the deferment rate to be applied to the value of the storerooms on the eighth floor of the block also remained to be determined, but since that issue has not been raised in the submissions made since the hearing we assume that it has been resolved.

4. At the hearing in October 2010 expert evidence as to the appropriate deferment rates was given orally and in writing on behalf of the landlord by Mark Bezant FCA of FTI Consulting Inc and by Julian Clark BSc MRICS of

Gerald Eve, chartered surveyors, and on behalf of the nominee purchaser by Peter Beckett FRICS of Beckett and Kay, chartered surveyors. After the hearing we received written submissions from Michael Pryor for the landlord dated 18 March and 16 March 2011 and from Stephen Jourdan QC for the nominee purchaser dated 18 February and 23 March 2011.

The evidence as to deferment rates given at the hearing

Mr Bezant's evidence

5. Mr Bezant's evidence was lengthy and complex, and he was cross-examined at length by Mr Jourdan. However, in the light of *Erkman*, the landlord did not fully rely on his proposed approach for the purpose of the present case.

6. His preferred approach to the deferment rates applicable to the short leases was to use the rates determined in *Earl Cadogan v Sportelli* [2007] 1 EGLR (Lands Tribunal) and [2008] 1 WLR 2142 (Court of Appeal) for leases of over 20 years, adjusting only for changes in the risk-free rate at the valuation date, to use rental yields to determine the deferment rate for a one year terms, and then to join the two points to generate a deferment rate curve applicable to all leases with less than 20 years unexpired. Adopting this approach, and applying a rental yield of 3% for the first year and a risk-free rate of 1.5% rather than the 2.25% applied in *Sportelli*, he arrived at a deferment rate of 4%. Using, as an alternative, only the *Sportelli* formula, but adjusted to take account of his proposed risk-free rate of 1.5%, he arrived at a deferment rate of 4.25% for the reversions to both short and long leases.

7. His proposed risk-free rate of 1.5% was derived from his review of the long term risk free rate using a five-year moving average for 10 and 20 year zero coupon redemption yields. He considered that there was a continued downward trend in such yields and that 1.5% was appropriate at the valuation date. His view was that the expected growth rate in property values and risk

factors affected both freehold and reversionary values in equal measure and should not affect the deferment rate, either for short or long leases.

Mr Clark's evidence

8. Mr Clark supported Mr Bezant's conclusions. He said that, in addition to the risk-free rate, the other elements of the *Sportelli* formula, namely the long term real growth rate and the risk premium, were also capable of review, but the landlord was not presenting evidence to support such reviews in the present case. He said that he did not agree with the 0.25% addition for management risks for flats made in *Sportelli*, particularly where there was a headlease as in the present case, but he accepted that he should be guided by *Sportelli* and did not argue against it in this case. Referring to the arguments as to the growth rate presented by Professor Colin Lizieri in *Erkman*, he said that if the same arguments were put forward in the present case they should lead to no downward adjustment to the *Sportelli* growth rate of 2% because the Nationwide review of Long Term Real House Price Trends for September 2009 indicated that capital values had returned to long term trend at that date.

Mr Beckett's evidence

9. Mr Beckett proposed a deferment rate of 5.8% for the reversions to the short leases and of 6% for the reversions to the long leases.

10. He said that he was not a financial expert and was not qualified to give evidence as to the risk-free rate. He did not seek to argue that the property risk premium should be increased in the present case because the landlord was protected from management risks by the intermediate landlord, and accepted that the *Sportelli* risk premium of 4.5%, and an addition of 0.25% for flats, should apply. He considered, however, that the purchaser of a reversion to a lease of less than 20 years would not assume that his investment would

achieve the average growth rate until reversion, and that a lower growth rate than the growth rate of 2%, assumed in *Sportelli*, should be assumed in the present case. He said that at an unexpired term of one year he would expect the assumed growth rate to be 10% and that the growth rate at 11.82 years was "anybody's guess", but for present purposes he adopted the deferment rate supported by Professor Lizieri in *Erkman*, although he reserved the right to revise that view if the present case is the subject of an appeal to the Upper Tribunal.

11. In his supplementary report for the hearing in which he responded to Mr Bezant's written evidence, he said that if Mr Bezant was correct to take an unexpired term of one year as his starting point for arriving at the deferment rate for a short lease, which he probably was, he should have started with a discount of at least 8%, and probably 10%, from freehold vacant possession value, because that was the discount which an investor would expect when buying a freehold subject to as assured shorthold tenancy, and that on that basis the deferment rate for the short leases in the present case should be in the order of 7%.

12. He considered that a hypothetical purchaser would attach little weight to the pure reversion in 101.81 years' time and that the deferment rate for the reversions to the long leases should be 6%.

Erkman

13. The *Erkman* appeals to the Upper Tribunal were concerned with five properties converted into flats. The valuation dates ranged from 22 June 2005 to 29 August 2007 and the lengths of the unexpired terms from 15.6 to 17.8 years. The hearing occupied five days, and evidence was given for the nominee purchasers by Professor Lizieri and Gavin Buchanan MRICS of Knight Frank LLP and for the landlord by Mr Bezant and Mr Clark.

14. As recorded in the decision, the landlord's case was that for terms of less than 20 years a net rental yield approach should be used to determine the deferment rate, and that the evidence of net rental yields suggested that the deferment rates should be less than 5%. Mr Bezant's evidence was that, if the *Sportelli* approach was to be adopted, the risk-free rate should be 2.25%, as in *Sportelli*, and that the real growth rate and risk premium were counter-balanced.

15. The Tribunal rejected the net rental yield approach and concluded (from paragraph 182) that there was only one approach open to it on the evidence, which was an approach which relied on the exercise of valuation judgment. The Tribunal took the *Sportelli* formula as a starting point and asked itself (paragraph 188) whether, on the evidence, the position in the property cycle at the valuation dates should lead to a change in one or more components in that formula. It concluded that it was not appropriate to regard the real growth rate and the risk premium as coupled together, and that, since the argument had been about expected growth rates, those were the obvious components to consider. The Tribunal's view was the selection of the real growth rate should be made by assessing what hypothetical parties in the open market would arrive at as a result of negotiation, which was a valuation question, involving the use of valuation judgment, to be made by reference to the evidence of market conditions at the valuation dates. It said that this approach was appropriate for all cases with leases of 10 to 20 years. On the evidence the Tribunal arrived at deferment rates of 5.25% for the cases with 2005 valuation dates and of 5.5% for those with 2007 valuation dates.

Mr Jourdan's written submissions dated 18 February 2011

16. Mr Jourdan submitted that Mr Bezant's evidence that the risk-free rate at the valuation date was lower than the *Sportelli* rate should be rejected. He submitted that in determining the risk-free rate it was necessary to choose a period sufficient to avoid, or capable of allowing for, distortions to the market such as the "pension panic" and the banking crisis. He submitted that Mr

Bezant had made no attempt to do so, but had, rather, treated the reference in *Sportelli* to "average index linked yields on a five year rolling basis over the last decade" as though it was a mathematical formula to be applied in a rigid and unthinking way.

17. He submitted that, on the basis of the guidance in *Erkman*, the enquiry was a "retrospective exercise in probabilities, wholly derived from the real world", and that in the present case the important facts in considering the likely outcome of negotiations between the seller and the prudent buyer of the freehold were the shortness of the unexpired terms, and that price growth in the block had been far above trend, and that the compromise which would be reached in negotiations between seller and buyer would be at a deferment rate substantially above 5%, the purchaser asking for a deferment rate of well above 6% and the seller asking for 5%, compromising at 5.8%. For the reversions to the long leases he submitted that 6% was the appropriate rate, as Mr Beckett had suggested.

Mr Pryor's submissions dated 8 March 2011

18. These submissions were prepared without the benefit of Mr Jourdan's submissions dated 18 February, which had not at that date been served on the landlord, and were made on the assumption that the only issue between the parties was the risk-free rate which, on the basis of Mr Bezant's evidence, Mr Pryor submitted should be 1.5%. He submitted that Mr Bezant's evidence as to the risk-free rate was not only persuasive but unopposed by financial evidence from the nominee purchaser and should thus inevitably be accepted.

Mr Pryor's submissions dated 16 March 2011

19. Having received Mr Jourdan's submissions, Mr Pryor responded.

20. He said that, the Upper Tribunal having rejected much of the thrust of Mr Bezant's evidence, also given to the present tribunal, the landlord did not ask for a determination on those arguments but reserved its position for any appeal. He submitted, however, that Mr Bezant's evidence as to the risk-free rate should be accepted, and that, at the valuation date, it was notable that every five-year rolling average for three or four years showed a risk-free rate of below 2%.

21. He submitted that the only evidence before the present tribunal relevant to the assessment of the correct real growth rate at the valuation date was that of Mr Clark to the effect that the assumed growth rate should be no less than the *Sportelli* rate. He submitted that Mr Jourdan's reliance on values in the particular building had no basis, the task being to identify a generic rate, and that it was impossible, on the basis of the evidence before the tribunal, to identify the true position. He said that Mr Beckett's proposed rate of 6% for the long leases was a direct challenge to *Sportelli* and should be rejected.

Mr Jourdan's submissions dated 23 March 2011

22. Mr Jourdan said that there was a mathematical difference between the prices produced by the parties' valuers at different deferment rates and that the tribunal should direct them to seek to agree the figures for the purpose of the valuation or, if not agreed, to provide a summary of the differences for the tribunal.

Decision

23. One obvious difficulty in this aspect of the case arose from the course the proceedings took. *Erkman* had been heard but was undecided at the time of our hearing, and most of the evidence we were given as to deferment rates was directed at different factors by each side. Accordingly, much of the landlord's evidence, but none of the nominee purchaser's, related to financial

considerations, and very little, of the evidence of either side related to the considerations which the Upper Tribunal subsequently held to be important.

24. We do not accept Mr Pryor's submission that, because Mr Bezant's evidence was not contradicted by financial evidence from the nominee purchaser, we are bound to accept it. That is not what, as an expert tribunal, we are bound to do. We are entitled to, and do, reject Mr Bezant's evidence as to the appropriate risk-free rate, with which, we are satisfied, other financial experts might well disagree. We accept Mr Jourdan's submission that Mr Bezant did not in his evidence address all the issues which were likely to have affected risk-free rates at the valuation dates. We are also inclined to reject Mr Bezant's evidence that growth rates and risks are inevitably counterbalanced and consider that it is possible, although not established on the evidence we received, that growth rates at the valuation date might differ from the rate assumed in *Sportelli*.

25. Mr Clark said that he considered that values had returned to trend at the valuation date, but he did not argue for an assumed growth rate different for that assumed in *Sportelli*. Mr Beckett in his evidence proposed a rate of 5.8% (or higher), derived from Professor Lizieri's evidence in *Erkman*. Such evidence was not related to the valuation date in the present case and was based on general impression rather than market evidence. He said (at paragraph 4.2.8 of his first report) that "general sentiment had moved from pessimistic to optimistic at the valuation date, but it is hard to say how the world of likely purchasers would have viewed this". Mr Jourdan submitted that values, on the basis of our decision, were above trend.

26. We are satisfied that the evidence and arguments presented to us do not justify a departure from the generic deferment rate for flats derived from *Sportelli*. It is possible that further and better evidence from each party as to each of the components of the *Sportelli* formula might have led us to a different conclusion, but it was not given to us. We determine that the deferment rate for the reversions to the short and long leases should be 5%, there being no compelling evidence to the contrary.

Other matters

27. Since the hearing the decision of the Court of Appeal in *McHale v Earl Cadogan* ([2010] EWCA Civ 1471) has been issued and we will thus, as anticipated in paragraph 46 our previous decision, value the nominee purchaser's, as well as the landlord's, interests on the basis that the value of rights under the Act should be disregarded.

28. We accept the offer of the parties' valuers to prepare a valuation, or valuations if they cannot agree, based on what we have determined. When we receive their valuation it will be attached to an addendum to this decision. We confirm that the time for seeking permission to appeal from this decision will not start to run until the valuation has been issued.

CHAIRMAN.....

DATE: 23 May 2011