UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – flat – premium – deferment rate – whether Sportelli starting point to be adjusted to reflect different growth rates in Horsham and Prime Central London and increased management burden with flats – whether any adjustment for flats affected by presence of head lease – deferment rate reduced from 6% to 5½%.

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE SOUTHERN RENT ASSESSMENT PANEL

BETWEEN:

CITY & COUNTRY PROPERTIES LIMITED **Appellant**

and

ALEXANDER CHRISTOPHER CHARLES YEATS **Respondent**

Re: 25 Bishopric Court
Horsham
West Sussex
RH12 1TH

Before: His Honour Judge Nicholas Huskinson and N J Rose FRICS

Sitting at: 43-45 Bedford Square, London WC1B 3AS
on 2 July 2012

Gary Cowen, instructed by Wallace LLP on behalf of the Appellant
Anthony Radevsky, instructed by ODT Solicitors LLP, on behalf of the Respondent

The following cases are referred to in this decision:

Cadogan v Sportelli [2007] 1 EGLR 153
Cadogan v Sportelli [2007] EWCA Civ 1042
London Borough of Camden v The Leaseholders of 37 flats at 30-40 Grafton Way, (LRX/185/2006, unreported)
Hildron Finance Ltd v Greenhill Hampstead Ltd [2008] 1EGLR 179
Zuckerman and others v Trustees of the Calthorpe Estate [2010] 1EGLR 187
Daejan Investments Ltd v The Holt (Freehold) Ltd (LRA/133/2006 unreported)
Daejan Investments Ltd v Benson [2011] 1WLR 2330
Cik v Chavda (LRA/111/2007, unreported)
31 Cadogan Square Freehold Ltd and *37 Cadogan Square Freehold Ltd v Cadogan* [2010] UKUT 321(LC)
Inland Revenue Commissioners v Clay [1914] 3KB 466
Lady Fox's Executors v Commissioners of Inland Revenue [1994] 2 EGLR 185
Railtrack Plc v Guiness Ltd [2003] 1 EGLR 2004

DECISION

Introduction

1. This is an appeal from a decision of the Leasehold Valuation Tribunal for the Southern Rent Assessment Panel ("the LVT") dated 22 November 2010 whereby the LVT determined the price to be paid by the Respondent as the premium for the grant of a new lease under sections 39 and following of the Leasehold Reform, Housing and Urban Development Act 1993, in respect of flat 25, Bishopric Court, Horsham, West Sussex, RH12 1TH ("the Property").

2. The LVT carried out an internal and external inspection of the Property and of Bishopric Court and its surroundings. The LVT described the Property in paragraphs 11-14 of its decision in the following terms:

> "No 25 Bishopric Court is a first floor flat in a 4 storey purpose built block of 54 flats C 1930. Though the block is situated close to the centre of town it is poorly sited at the rear of a secondary parade of shops with flats over the shops. A small block of 22 garages is adjacent to the site and there is limited parking at the front with severe clamping restrictions for unauthorised users. An unsightly bin area is situated to the side and close to the front of the building.
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> Bishopric Court is a very plain building with spartan communal staircases leading to galleried open landings serving flats at each floor level. The communal areas are somewhat bleak, have not been well maintained and are due for redecoration. There is one small passenger lift in the centre of the block. However, this was not working at the time of our inspection. The block forms an irregular horseshoe shape around a garden area and overlooks a bowling club at the rear.
>
> Overall the block is unattractive and 'tired' with evidence of peeling paintwork. There is a general air of a lack of any planned maintenance, or any sign of upgrading, or improvement. The building is of plain brick construction under a part tiled and part flat roof. The dated windows are principally of metal "crittall" style in timber sub frames. The flats are provided with central heating radiators and hot water from a communal oil fired boiler.
>
> We inspected Flat numbered 25 internally. The accommodation comprises a small living room, 2 very small bedrooms, a tiny kitchen with dated units and a small bathroom/WC with basic white fittings. Three radiators are provided as part of the communal system."

3. Neither the Appellant nor the Respondent suggested that we should carry out any site inspection. So far as concerns the description of the Property we proceed on the basis of the description given by the LVT.

4. The lease structure can be briefly described as follows:

(1) The Appellant is the original lessor who by a lease dated 31 May 1984 demised to the predecessor in title of the Respondent the Property for a term of 99 years from 25 March 1977 at a rent of £60 (subject to increase to £90 pa from March 2010 and £120 pa from March 2043). The lease contained covenants by the Appellant as lessor that, subject to payment of the service charge contributions, it would repair and decorate etc and manage the building.

(2) By an overriding head lease dated 15 March 1988 the Appellant demised to a head lessee (whose name does not matter and is entirely obscured by the stamp on the photocopy document before us) the whole of Bishopric Court subject to the leases of the 54 flats. The term was 99 years plus one day from 25 March 1977, that is one day longer than that of each of the leases of the individual flats. This lease was granted in consideration of a premium of £1,650. The annual rent reserved was £2,662 pa with the provision that this rent should increase by such amount as the total rents receivable by the head lessee increased pursuant to the provisions for increase in the rents payable under the leases of the individual flats. This lease imposed full repairing and decorating etc obligations upon the head lessee and also contained in clause 2(24) a covenant by the head lessee (as an additional covenant and not in diminution of any other obligation of the head lessee) to comply with all of the covenants and obligations on the part of the Appellant contained in the various leases of the individual flats and to indemnify the Appellant from any losses etc suffered by the Appellant arising directly or indirectly out of any breach of any such covenants and obligations. By the valuation date the head lease had become vested in Fencott Limited. Fencott played no part in the hearing before the LVT or in the appeal to this Tribunal. However as will be seen below a separate price was fixed for payment to Fencott.

The LVT's decision

5. The LVT's decision resulted in a determination that the Respondent should pay to Fencott as head lessee £1,312 and to the Appellant as freeholder £8,906. The nature of the LVT's valuation is set out in Appendix 1 hereto.

6. It will be seen that an important element in the LVT's calculation of the price to be paid as the diminution in value of the Appellant's present interest was the deferment rate, which the LVT took at 6%. The LVT reminded itself of the starting point for the deferment rate in respect of flats of 5% as laid down in the decision of the Lands Tribunal in *Cadogan v Sportelli* [2007] 1 EGLR 153. The LVT made reference to the Court of Appeal decision in *Sportelli* (*Cadogan v Sportelli* [2007] EWCA Civ 1042) and it quoted the following passage from paragraph 102 of that decision:

"The issues within the PCL were fully examined in a fully contested dispute between directly interested parties. The same cannot be said in respect of other areas. The judgment that the same deferment rate should apply outside the PCL area was made, and could only be made, on the evidence then available. That must leave the way open to the possibility of further evidence being called by other parties in other cases directly concerned with other areas. The deferment rate adopted by the Tribunal will no doubt be the starting point, and its conclusions on the methodology, including the limitations of market evidence, are likely to remain valid. However, it is possible to envisage other evidence being called, for example, on issues relevant to the risk premium for residential property in different areas."

7. The LVT concluded that the deferment rate should be increased above 5% on three separate bases, namely:

(1) An additional 0.5% for additional risk that growth will not be achieved at the same rate as for Prime Central London ("PCL");

(2) An additional 0.25% for obsolescence, and

(3) An additional 0.25% for the risks involved in the management of this block of leasehold flats.

(See paragraph 33 of LVT's decision).

8. The reasons given for these three additions to the 5% *Sportelli* starting point were based upon the LVT's appraisal of Bishopric Court and were substantially founded upon the decision of this Tribunal in *Zuckerman v Trustees of the Calthorpe Estate* [2010] 1 EGLR 187. The LVT's reasons were as follows.

9. As regards obsolescence (which we take first because there is no longer any dispute on this point – permission to appeal against the LVT's conclusions on this point having been refused) the LVT in paragraph 44 said this:

"In *Zuckerman* the Upper Tribunal heard evidence that the values of the properties in the *Sportelli* decision were of a different magnitude to those in Kelton Court, situated in the Midlands. We have concluded that the difference between the value of the flats in this application and those considered in the *Sportelli* case is very significant. Added to that is Mr Pridell's experience that building costs in the local area are comparable to those in London. We conclude, therefore, that it is likely to remain economically viable to repair high value flats in PCL for much longer than will be the case for similar sized flats in the subject premises. Even though the flats are leased on full repairing covenants, there is a much greater risk of deterioration at the subject premises than there is in PCL and this is not reflected in the vacant possession values. This leads us to the conclusion that an investor would expect an additional 0.25% in the risk premium to reflect this factor. This is also supported by the decisions in the *Re Lethaby* case as well as the *Zuckerman* case."

10. So far as concerns the additional 0.5% for the difference in prospects of growth between Bishopric Court on the one hand and PCL on the other hand the LVT said as follows in paragraphs 45 to 47:

> "45. As to the prospects for future growth, Mr Pridell produced evidence which he argues shows a much slower growth rate for properties in the local area. He told us that he had adapted the methodology used in the *Zuckerman* case in his report (having spoken to the leaseholder's valuer in that case). As the Upper Tribunal noted in *Zuckerman*, there are limitations on the use of statistical evidence but there, as in this case, the available evidence suggests a significantly lower growth rate than in the PCL. Conversely, in the *Re Lethaby* decision the leaseholders did not produce any evidence to compare growth rates in East London (where the property is located) and the PCL.
>
> 46. Mr Sharp produced evidence in the form of comparison of prices in the Westminster and West Sussex areas to try to show that growth rates are similar in the two areas. However, our reading of his graphs suggests a different conclusion, namely that with the exception of periods between 2003 and 2005 that property prices were higher in the Westminster area, a trend that has become pronounced since the beginning of 2008.
>
> 47. The evidence put forward leads us to conclude that an investor who is examining long-term growth would not be confident that the PCL rate of growth would be achieved in the Horsham area and that he would adjust his bid for the subject premises accordingly. Following the reasoning in *Zuckerman* we conclude that the prospect of such a reduction in an investor's bid should be assessed by a further increase in the risk premium by 0.5%."

11. So far as concerns the additional 0.25% for management risk the LVT dealt with this in the following manner:

(1) The LVT cited from paragraph 95 of the *Sportelli* decision in both paragraphs 48 and 50 of its own decision. We set out paragraph 95 of *Sportelli* in full here together with paragraph 96:

> "95. In *Arbib* the adjustment of 0.25% was intended to reflect both the greater management problems associated with flats and the possibility that there might be a better prospect of growth in the house as opposed to the flat market. As to the second of these factors we accept Mr Clark's view that any disparity between growth rates for houses and flats is likely to even out over the longer term. We think, however, that an adjustment needs to be made to reflect the management problems, although we do not consider it appropriate to differentiate between flats that are the subject of head leases and those which are not. Nor do we think that the management concerns are necessarily so much less for a single flat than for a block to warrant a different adjustment. Even where flats are efficiently managed, service charge and repairs problems inevitably occur, and the management exercise in itself is, we feel, sufficiently more complex to warrant a generalised 0.25% addition for flats. We do not consider that any fine-tuning below this percentage is justified.

96. Because what we are considering is a long-term investment it is the prospect of management problems arising during the course of the tenancy that is the important consideration rather than the state of affairs at the time of valuation. Our view is that the potential for problems to arise is inherent in all leases and that standard adjustment is therefore appropriate. We do not rule out the possibility that there could be a case for an additional allowance where exceptional difficulties are in prospect, but this would need to be the subject of compelling evidence."

(2) The LVT referred to paragraph 56 of the *Zuckerman* decision which is in the following terms:

> "The provisions of [The Service Charge (Consultation Requirements) (England) Regulations 2003] are potentially extremely serious for landlords (see the Lands Tribunal decision dated 11 April 2008 (George Bartlett QC, President and N J Rose FRICS) in *London Borough of Camden and The Leaseholders of 37 flats at 30-40 Grafton Way*, (LRX/185/2006, unreported). I accept Mr Rutledge's evidence that, although LVT's have only heard a limited number of service charge appeals relating to properties in Birmingham, there have been other examples of landlords of such properties agreeing to bear part of the cost of disputed items without the need for a Tribunal hearing. The 2003 Regulations came into force on 31 October 2003. I am satisfied that by September 2007, the first date with which I am currently concerned, the market was more aware of the dangers posed by the regulations than was the case in *Sportelli*, where the properties fell to be valued between 2¼ and 3¾ years earlier. I conclude that, in the eleven cases with which I am currently concerned, investors would have required an addition of 0.5% to reflect the greater management problems associated with flats than with houses. In reaching this conclusion, I have borne in mind that the subject flats are no longer subject to the original head lease. Had that head lease still been in existence, I would not have considered it appropriate to depart from the *Sportelli* uplift of 0.25%."

(3) The LVT stated that it found it difficult to reconcile the position taken in *Zuckerman* (which indicated that the additional 0.25% would not have been added had the head lease still been in existence) with the statement in paragraph 95 of *Sportelli* (which indicated that the Lands Tribunal did not consider it appropriate to differentiate between flats that are the subject of head leases and those which are not). The LVT considered it should follow *Sportelli* because its decisions on the deferment rate were upheld by the Court of Appeal, such that one should not differentiate between cases where the flats have head leases and those where there is no head lease.

(4) The LVT noted that in *Zuckerman* the landlord's responsibilities included the maintenance of the structure and common areas of the flats and a separate block of garages, private roads and amenity areas.

(5) In paragraph 52 of its decision the LVT said:

> "We conclude that an investor would require an addition of 0.5% to reflect in this case, the greater management responsibilities with flats than with houses. As our inspection revealed, the block bears the marks of a poorly maintained building with higher service charges that (on the basis of our professional experience) are higher that one would expect for a block of this size."

(6) The LVT also referred to the Lands Tribunal decision in *Daejan Investments Limited v Benson* [2011] 1WLR 2330 where the Tribunal, which included the Senior President of Tribunals (Lord Justice Carnwath – as then was), stated:

> "… the potential effects – draconian on the one side and a windfall on the other – are an intrinsic part of the legislative scheme."

The LVT observed that this was an example of how the stricter legal framework governing leasehold flat management carried additional financial risks, being risks of which the market has become aware.

The issues in this appeal and the expert witnesses

12. Before the LVT there were additional matters in dispute between the parties beyond merely what the deferment rate should be. However the only matters challenged upon this appeal are matters relating to the deferment rate. The Appellant sought to challenge all of the three steps by which the LVT departed from the *Sportelli* 5% rate but, as we have said, the Appellant was refused permission to challenge the additional 0.25% for obsolescence. In granting permission to appeal the President ordered that the appeal would be limited to the issues of capital growth and management and their effect on the deferment rate. The appeal was ordered to be by way of rehearing.

13. At the hearing we received oral evidence from Mr R D Sharp BSc FRICS on behalf of the Appellant and Mr A Pridell FRICS on behalf of the Respondent. Both experts had produced written reports which were adopted as their evidence in chief and they were then subject to cross-examination.

Evidence on behalf of the Appellant

14. On behalf of the Appellant Mr Sharp gave the following evidence in respect of the question of whether 0.25% should be added to the deferment rate to reflect potential management problems:

(1) Mr Sharp adopted his opinion as expressed in paragraph 7.3.1 of his report to the effect that there are no exceptional management difficulties with the present property, not least because the head lessee takes on this responsibility, not the Appellant as freeholder.

(2) With regard to the effect of the 2003 Regulations (and in particular the consultation requirements) Mr Sharp agreed that there was a greater degree of consultation required now when managing a building, especially in respect of major works, but that investors have taken all this in their stride – consultation runs along tramlines. He stated that from personal experience as a director from time to time since 1982 of the management company of a block of flats in Croydon, the management of houses and flats is easier and more efficient than it was in 1982. He stated that initial reservations and difficulties flowing from the Regulations had been overcome by the valuation date in March 2010; and that residential property in all its forms is a very popular investment.

(3) During the course of his cross-examination Mr Sharp appeared to be seeking to disagree with the LVT's description of Bishopric Court in general and of the Property in particular (set out in paragraph 2 above). However it was pointed out that this disagreement with the LVT did not appear to be part of his written report nor to be a matter on which permission to appeal had been granted. It was at this stage accepted on behalf of the Appellant that we were not being asked to carry out a site inspection and that we should proceed on the basis of the description of Bishopric Court and of the Property as given by the LVT.

(4) Mr Sharp sought to refer to the service charge accounts at Bishopric Court in support of his contention that there were no management problems. It was however pointed out to him in cross-examination that, of the documents he produced, certain of them were in respect of a period substantially after the valuation date. As regards the documents he had produced dealing with the state of the accounts as at 31 March 2010 (just after the valuation date) he accepted that the accounts showed that the state of the bank accounts at the end of the year was that the account was £3,681 overdrawn and that there was a £15,557 bank loan. The accounts also showed that the arrears of service charge had increased from £29,693 at the beginning of the service charge year to £68,877 at the end.

(5) Mr Sharp was asked about the risk that the head lessee (at present Fencott Limited) would disappear (e.g. default or go into liquidation) such that the freeholder would once again have to take over managing the building. It was pointed out to him that there had already been five previous statutory extensions with the grant of long leases at a peppercorn, so that already the head lessee was receiving less rent than it was paying over. Mr Sharp said that he did not know who was behind the head lessee and that he had not investigated the head lessee but he concluded there was no evidence that the head lessee would fail to continue performing all its obligations under the head lease. He did not agree that a prudent purchaser of the freehold interest in the Property would be concerned that the freeholder might have to take over management of Bishopric Court.

(6) He pointed out that a decision of a leasehold valuation tribunal – relied upon by Mr Pridell concerning a property called Ashdown in Hove – was very different from the present case because there there existed serious maintenance problems, which was not the case at Bishopric Court.

(7) In summary he concluded that the 0.25% already allowed in *Sportelli* in the deferment rate for leases of flats as opposed to leases of houses was sufficient in the present case – there was no justification for adding a further 0.25% to the deferment rate.

15. Mr Sharp also considered that there was no justification for increasing the *Sportelli* deferment rate to reflect higher long term growth prospects in PCL than in Horsham. There was in his view no reliable evidence to prove the existence of such a differential. He produced figures taken from the Land Registry House Price Index report showing average prices paid each month between January 1995 and July 2011 in the areas administered by the West Sussex Council and the City of Westminster. He said these figures showed that for a time prices in West Sussex lagged behind those in Westminster, but between September 2003 and January 2006 the position was reversed. Since then values in Westminster had grown more rapidly.

16. In Mr Sharp's view this evidence did not conclusively demonstrate long term value trends. Firstly, the period covered by the data was much shorter than the 50 years which, in *Hildron Finance Ltd v Greenhill Hampstead Ltd* [2008] 1EGLR 179 (para 39), the Lands Tribunal had suggested was the time-scale required to justify a departure from the *Sportelli* deferment rate. Secondly, the two indices did not compare properties which were necessarily on all fours in terms of condition or lease length. Thirdly, it was not known which point the starting date of January 1995 represented in the property cycle of each location. Fourthly, the index in West Sussex had caught up with that in Westminster in the past and might do so again.

17. Mr Sharp added that he had since 1998 regularly acted for claimants in a section of Bryanston Square, London, W1, situated in the City of Westminster, where houses had been divided into flats. In 1998 nearly all the units had been held on leases expiring in 2017. Most had since been extended, resulting in significant increases in their value and a consequent upward impact on the index. In Bishopric Court, by contrast, only 5 leases had been extended out of a total of 54. This difference would have had a considerable effect on the relationship between the two indices. Moreover, in several of the Bryanston Square cases with which he had been concerned the lessees had added bathrooms, enlarged kitchens and undertaken expensive refurbishment works. Mr Sharp said that it was common for such improvements to be effected in prime areas, and this too would have led to increased values in Westminster relative to those in West Sussex.

18. He made two additional points. He produced a copy of an article in the Financial Times dated 28 September 2011. This stated that the housing shortage was widely predicted to become worse in the foreseeable future, making it more likely that residential values would rise. He also suggested that caution should be exercised in interpreting graphs which showed increases in capital values along one axis rather than percentage increases, since they tended to exaggerate the growth rate. In the course of the cross examination of Mr Sharp it was pointed out that by reference to his analysis of relative price movements in West Sussex and Westminster, the increase in West Sussex prices from 1995 to 2011 (from a base of 100 to 294) was considerably less than in Westminster (from a base of 100 to 442).

Evidence on behalf of the Respondent

19. So far as concerns the additional 0.25% for management risk, Mr Pridell gave the following evidence:

(1) He dealt with the point briefly in his written report in that, having referred to the *Zuckerman* decision, he stated:

> "Increasing Management difficulties – with the introduction of more complex Section 20 procedures under the Commonhold and Leasehold Reform Act 2002, it was acknowledged that management had become a far more difficult field and 0.25% was added to reflect this."

(2) Mr Pridell also referred to two leasehold valuation tribunal decisions where he had succeeded in arguing for a deferment rate of more than the 5% *Sportelli* rate, namely *Ashdown Hove Ltd v Remstar Properties Ltd* (CHI/OOML/OCE/2008/0025) and *Hardwicke House Freehold Ltd v Land & Equity Holdings Ltd* (CAM/21UF/OCE/2010/0006)

(3) Mr Pridell said he had experienced situations where a head lease had been forfeited which had led to what he referred to as a giant mess. He considered that the section 20 procedures gave rise to a substantial scope for argument with potential disadvantage to freeholders who had the responsibilities as landlord.

(4) Mr Pridell stated that he did not think it made any difference whether or not there was a head lease between the freehold and the occupying lessees. This is because the freeholder would in any event be at risk of becoming involved in burdensome management if for instance the head lessee effectively disappeared (e.g. by being wound up or by failing to comply with its obligations).

(5) He did not seek to go beyond what the LVT said in its decision so far as any criticism of the state of Bishopric Court was concerned, but he contended that the LVT (in the passage set out in paragraph 2 above) was effectively recognising that Bishopric Court was a complete mess (as he put it).

(6) He personally had experience of many disputes regarding service charges including especially regarding section 20 matters. He had made enquiry of the senior clerk to the Southern Rent Assessment Panel as a result of which he produced a table showing the number of service charge cases which were the subject of applications to the LVT for the years 2002 onwards. These showed that the amount of applications is increasing. The information he had was that approximately 10% of these applications relate to section 20 procedures, such that the section 20 matters were increasing in line with the increase in general service charge applications.

(7) Bearing in mind the risk of substantial management problems arising at a property such as Bishopric Court and bearing in mind the potential hazards for landlords who had to deal with them, Mr Pridell concluded that the LVT was correct in adding 0.25% to reflect additional potential management problems (including potential section 20 problems arising from the consultation requirements).

20. Mr Pridell's evidence on the long-term growth prospects in Horsham as compared to PCL was as follows. In *Zuckerman* the Lands Chamber added 0.5% to the *Sportelli* risk premium (and thus to the deferment rate) to reflect the fact that a hypothetical investor would be less confident that a real growth rate of 2% would be achieved in the West Midlands than in PCL. Mr Pridell said that, in his view, the circumstances in *Zuckerman* were precisely the same as in the present case. In support of this opinion he produced three documents. One, headed "Indices and Graph Data", showed figures for UK house prices taken from statistics produced by the Nationwide Building Society from 1952 to 2008; prices for flats taken from the Nationwide Regional Table for the Outer Metropolitan Area from 1991 to 2010; rolling 12 month average prices in Kensington and Chelsea between 1992 and 2008 produced by the Halifax Building Society; prices from the Knight Frank Central London index, covering all properties in that area from 1976 to 2008; flat prices in London from the Nationwide between 1992 and 2008; and average prices in Bishopric Court itself between 1984 and 2010. The second document listed all flat sales in Bishopric Court of which Mr Pridell was aware between 1999 and 2009 and the third was a graph incorporating all the information on the first two schedules.

21. In oral evidence in chief Mr Pridell said that this graph was identical to the one produced by Mr Rutledge, the tenants' valuer in *Zuckerman* – whose evidence to the effect that there was a differential in growth prospects between PCL and the West Midlands had been accepted by the Tribunal – except that the sloping lines illustrating price movements in the West Midlands and the subject block of flats in *Zuckerman* – Kelton Court in Edgbaston – had been replaced by those for the Outer Metropolitan Area and Bishopric Court.

22. In cross examination Mr Pridell stated that, whatever the Lands Tribunal may have said in *Hildron Finance Ltd v Greenhill (Hampstead) Ltd* [2008] 1 EGLR 179 regarding the need to examine price movements over a period of about 50 years (if a departure from the *Sportelli* rate was to be justified), the hypothetical purchaser of the freehold interest in the Property, acting in the way such a purchaser would act in the market, would not examine a period of 50 years for the purpose of deciding what deferment rate to use when assessing his bid. An actuary or one of the financial experts called in *Sportelli* might seek to look back 50 years but the hypothetical purchaser would not do so. Instead such purchaser would adopt an unsophisticated approach to the exercise. He said the purchaser "would look at a trend – almost a back of a fag packet approach – with an eye on a shorter time horizon than 50 years." The Tribunal should examine how the hypothetical purchaser would cast his bid assuming such purchaser proceeded in this manner and had a reasonable general knowledge of the market and performed a

moderate amount of research (but with such research not extending back over 50 years – even if such material were available). If the problem was examined in this manner, the appropriate conclusion was that the hypothetical purchaser would expect to achieve lesser growth in the long-term at Bishopric Court as compared with PCL.

23. Mr Pridell accepted that the values shown in his material for flats at Bishopric Court became more significant from 1999 onwards. He did not seek to place any particular reliance upon the figures from 1984 to 1998 because the available information was incomplete. Mr Pridell made reference to the panel inserted onto the graph at page 324 of the bundle which he said showed an increase in prices between 1984 and 2010 of 546% in Bishopric Court and 937% in the Knight Frank Central London Index. He recognised, however, that this comparison was of limited value bearing in mind his acceptance that limited reliance could be placed upon the figures for Bishopric Court from 1984 to 1998.

Statutory provisions

24. Section 56 of the 1993 Act imposes the obligation upon the landlord to grant a new lease of the flat at a peppercorn rent for a term expiring 90 years after the term date of the existing lease. Such grant is to be made upon the payment of the premium calculated in accordance with *S*chedule 13.

25. Schedule 13 provides that the premium to be paid by the tenant in respect of the grant of the new lease is to be the aggregate of:

(1) The diminution in value of the landlord's interest in the tenant's flat as determined in accordance with paragraph 3 of *S*chedule 13.

(2) The landlord's share of the marriage value as determined in accordance with paragraph 4, and

(3) Any amount of compensation payable to the landlord under paragraph 5.

26. Paragraph 3 of *S*chedule 13 as amended lays down how the diminution in the value of the landlord's interest is to be calculated:

"3. – (1) The diminution in value of the landlord's interest is the difference between –

(a) the value of the landlord's interest in the tenant's flat prior to the grant of the new lease; and

(b) the value of his interest in the flat once the new lease is granted

(2) Subject to the provisions of this paragraph, the value of any such interest of the landlord as is mentioned in sub-paragraph 1(a) or (b) is the amount which at the relevant date that interest might be expected to realise if sold on the open market by a willing seller (with neither the

tenant nor any owner of an intermediate leasehold interest buying or seeking to buy) on the following assumptions –

(a) on the assumption that the vendor is selling for an estate in fee simple or (as the case may be) such other interest as is held by the landlord, subject to the relevant lease and any intermediate leasehold interests;

(b) on the assumption that chapter 1 and this chapter confer no right to acquire any interest in any premises containing the tenant's flat or to acquire any new lease;

(c) [this deals with improvements]

(d) [this deals with rights and burdens]

(3) In sub-paragraph (2) "the relevant lease" means either the tenant's existing lease or the new lease, depending on whether the valuation is for the purposes of paragraph (a) or paragraph (b) of sub paragraph (1).

(4) It is hereby declared that the fact that sub-paragraph (2) requires assumptions to be made as to the matters specified in paragraphs (a) to (d) of that sub-paragraph does not preclude the making of assumptions as to other matters where those assumptions are appropriate for determining the amount which at the relevant date any such interest of the landlord as is mentioned in sub-paragraph 1(a) or (b) might be expected to realise if sold as mentioned in sub-paragraph (2).

(5) …

(6) …"

Arguments on behalf of the parties - introduction

27. Before coming to the separate points raised on behalf of the Appellant and the Respondent it is appropriate for us first to record certain points which have not been raised in argument in the present case. This case is concerned with the extension of a lease upon a single flat. As seen from *S*chedule 13 of the Act, a crucial ingredient in the premium to be paid is the diminution in value of the landlord's interest in the flat. Paragraph 3 of *S*chedule 13 states how to determine this diminution in value of the landlord's interest. In the present case this exercise would appear to require examining the amount which the freehold in a single flat in Bishopric Court (a block of 55 flats) might be expected to realise on certain assumptions. No evidence in the present case has been given by either valuer directed towards any particular problems or benefits in offering for sale such an interest as opposed to offering for sale the freehold reversion upon an entire block such as Bishopric Court. In particular no arguments have been raised in the present case (nor any evidence given directed towards any such arguments) on the following points:

(1) The Respondent has not argued that the freehold reversion upon a single flat in a block (effectively a flying freehold) would attract little

interest in the market and would be an investment for which the purchaser would expect to pay a price based upon a deferment rate significantly higher than 5%.

(2) The Appellant has not argued that the purchaser of a flying freehold in a single flat would proceed upon the basis that, whatever problems regarding management might ever arise in the future, the owner of the freehold reversion on a single flat could leave it to the freehold owner of the rest of the block to manage it and would not need to get involved.

Accordingly both parties have proceeded upon the basis that, so far as concerns the two matters in dispute in the present case (namely whether any adjustment to the deferment rate should be made either for management problems or for growth rate) the analysis should proceed on effectively the same basis as would be appropriate if we were concerned with valuing the freehold of the entirety of Bishopric Court on a collective enfranchisement.

Appellant's submissions

28. On behalf of the Appellant Mr Cowen submitted that the starting point for choosing a deferment rate was the 5% as indentified in *Sportelli*. It was recognised in *Sportelli*, and in particular in the Court of Appeal decision in that case (at paragraph 102), that it may be possible to displace the starting point of 5% by reference to evidence called on issues relevant to the risk premium for residential property in different areas. In the present case there was no permission to appeal against the addition of 0.25% for obsolescence. Accordingly the starting point had become 5.25%. However if the Respondent contended, upon this appeal by way of rehearing, that any further addition to the deferment rate should be made then the burden was upon the Respondent to call evidence to justify such a departure. Mr Cowen submitted the Respondent had failed to do this.

29. As regards the question of whether 0.25% should be added to the deferment rate to reflect potential management problems Mr Cowen advanced the following arguments:

(1) The responsibility for management is placed upon the head lessee, who stands between the freeholder and the occupying lessees.

(2) An addition of 0.25% has already been made to the deferment rate to reflect the matters referred to in paragraph 44 of the LVT's decision which is dealing with obsolescence. It is necessary to have this firmly in mind and then to ask whether a yet further 0.25% should be allowed in respect of the risk of having to manage the building.

(3) Mr Cowen pointed out that the LVT stated it found it difficult to reconcile *Sportelli* (especially paragraph 95) with *Zuckerman* (especially paragraph 56) upon the question of whether the existence of a head lease made a difference as to whether an allowance for management problems should be made. He pointed out that the LVT

stated that it preferred the analysis in *Sportelli* but then appeared to adopt the decision in *Zuckerman*. He submitted that the LVT was in error in this respect. Having (correctly) stated it preferred the analysis in *Sportelli*, the LVT should have applied this analysis and adhered to the 0.25% added for management in *Sportelli* – this being the correct amount to add whether or not there was a head lease.

(4) Mr Cowen submitted that in fact there was no inconsistency upon this point between *Sportelli* and *Zuckerman* for the following reasons.

(5) It is appropriate to consider the reason why in *Sportelli* it was decided that an extra 0.25% should be added to the deferment rate for management risk irrespective of whether or not there was a head lease. He submitted that the explanation must be as follows. If the freehold interest which is being valued is an interest in reversion upon the lease of a single dwelling house then it is certain that no management problems will arise. The 0.25% addition in *Sportelli*, applied across the board to flats whether or not there exists a head lease, must be to reflect the lack of this certainty that no management problems will arise. Once one is concerned with a freehold which is in reversion upon flats then there is a risk that the purchaser of the freehold may at same time in the future become in some way involved with management problems.

(6) However the extra 0.25% allowed for management problems in *Zuckerman* is to reflect the particular problems for a landlord which may emerge from management on the facts of a particular case – especially problems from the consultation obligations regarding major works. Where (as here) a head lease exists between the freeholder and the occupying lessee, then these potential particular management risks are not of concern to the freeholder, so no additional 0.25% should be added to the deferment rate. However it is perfectly logical, and not inconsistent with *Sportelli*, to add this extra 0.25% in cases where there is evidence showing both the prospect of real management problems and also no head lease. In summary the first (*Sportelli* based) 0.25% is applicable in all cases involving flats (because flats are not houses so there is a possible risk of management problems arising) whereas the additional 0.25% (based on *Zuckerman*) is only applicable for cases where a real management risk can be identified and where the freeholder will have the burden of this risk because there is no protection from an interposed head lease.

(7) Mr Cowen submitted that by the valuation date (29 March 2010) some 6 ½ years had passed since the 2003 Regulations came into force. This was an ample period for the investment market to take into consideration and to react to the stricter consultation regime and (as Mr Sharp put it) to take management problems in its stride through familiarity and practice. If the consultation regulations were causing additional problems as at the valuation date, one would expect the percentage of section 20 based applications to the LVT to increase as a percentage of the total of service charge applications, but in fact the

evidence from Mr Pridell was that the percentage of section 20 cases remained static at about 10% of the total.

(8) Mr Cowen accepted that originally the Appellant had borne the management responsibility and had subsequently put in the head lessee between itself and the lessees. However the risk of the freeholder having to retake the management responsibility was small.

(9) Accordingly on the facts of the present case there is a head lease and there is no justification for the extra 0.25%.

(10) As regards Mr Radevsky's argument that, in the light of the 2003 Regulations and the *Zuckerman* case, an adjustment of 0.5% instead of 0.25% should be made to the deferment rate in all cases concerning flats (whether or not there was a head lease) Mr Cowen submitted that there is no sufficient basis for effectively re-writing the important *Sportelli* guidance upon this point.

30. Mr Cowen made the following submissions concerning growth rates.

(1) In *Hildron* the Lands Tribunal had said that evidence of relative growth rates in the vicinity of the subject property and in PCL should be obtained extending back 50 years in order to justify a departure from the Sportelli starting point, and different starting dates should be considered. In *Daejan Investments Ltd v The Holt (Freehold) Ltd* (LRA/133/2006, unreported) it was held that sale prices over a 15 year period did not come close to providing a reliable indication of long term growth rates. The evidence produced by Mr Pridell is over too short a period to enable any useful lessons to be learned.

(2) The statistical evidence regarding growth rates did not support a higher deferment rate than in Sportelli, even if the period it covers were found to be sufficiently long. The Land Registry information produced by Mr Sharp covered different types of property with different lease lengths. Prices in West Sussex consistently outperformed those in Westminster over a 2 year period. The Knight Frank Central London Index included houses as well as flats. In any event, if the evidence of sales in Bishopric Court before 1999 – which Mr Pridell accepted was unimportant – was excluded, the remaining sales did not show a rate of growth below that in the Knight Frank Central London Index. Although the Knight Frank Index had outperformed Bishopric Court if one went back to 1998, it did so by a relatively small margin.

(3) There was no evidence to show that the risk of Horsham values underperforming by comparison to those in PCL was not reflected in vacant possession values, apart from Mr Pridell's assertion to that effect.

Respondent's submissions

31. Mr Radevsky submitted that it was the Appellant's appeal and it was for the Appellant to show that the LVT was wrong. He accepted that this was an appeal by way of rehearing, but he submitted that this Tribunal should not lightly interfere with the decision of the LVT.

32. On the question of whether an additional 0.25% should be added to the deferment rate to represent management risk Mr Radevsky advanced the following arguments:

(1) He drew attention to the particular facts regarding Bishopric Court and the Property by emphasising the description given by the LVT in the light of their site visit (see paragraph 2 above).

(2) He emphasised that *Sportelli* at paragraph 95 stated that the adjustment to the deferment rate for flats to reflect management problems should be applicable whether or not there was a head lease. Accordingly it is now appropriate that the differential in the deferment rate as between houses and flats should be 0.5% not 0.25% in the case of all flats, whether or not there is a head lease. He relied upon paragraph 95 of *Sportelli* to indicate that the existence of a head lease makes no relevant distinction for this purpose.

(3) He submitted that this Tribunal was correct in *Zuckerman* to consider that the stricter consultation regime introduced under the 2003 Regulations had led to more management problems which had become more widely understood by the investment market as at the valuation date in *Zuckerman* (and a fortiori by the valuation date in the present case) than was the case at the relevant dates in *Sportelli*. This more onerous statutory regime for administering service charges, of which a salutary example is *Daejan v Benson*, applies to all properties containing flats, wherever located.

(4) As regards the observation of this Tribunal in *Zuckerman* at paragraph 56 to the effect that, had the head lease still been in existence, the Tribunal would not have considered it appropriate to depart from the *Sportelli* uplift of 0.25%, Mr Radevsky submitted that this remark was obiter and should not be followed. Instead the Tribunal should follow the analysis in paragraph 95 of *Sportelli* to the effect that the existence of a head lease does not make a relevant difference.

(5) If the Tribunal is against this submission that the adjustment should now be 0.5% (not 0.25%) in all cases of flats so as to reflect management problems, then Mr Radevsky submitted that having regard to the particular facts regarding Bishopric Court an additional 0.25% adjustment should be made (as was made by the LVT) because an investor in the freehold reversion would be concerned regarding the prospect at Bishopric Court of becoming involved with the burden and risk of management. He submitted that the head lessee could

effectively disappear, e.g. by becoming insolvent and going into liquidation or simply failing to comply with its obligations such that the freeholder effectively had no alternative but to forfeit the head lease and take over management. The head lease has no intrinsic value – indeed the rents payable are somewhat more than the rents receivable – and the head lessee could well decide that this head lease was merely a burden. There was no evidence to show that the head lessee (Fencott Limited) was a company of substance that could be relied upon dutifully to carry out all the management functions, without any costs to the freeholder, for the remainder of the unexpired 66 years of the existing lease.

(6) Mr Radevsky asked the Tribunal to note the two Leasehold Valuation Tribunal decisions relied upon by Mr Pridell.

33. Mr Radevsky made the following submissions on capital growth prospects.

(1) As in *Zuckerman*, the evidence in this case demonstrated that an investor would be less confident of achieving a real growth rate of 2% per annum in Horsham than in PCL. If certain short time periods were excluded, all the available statistics pointed to that conclusion.

(2) The only firm evidence produced by Mr Sharp itself showed that in the period of approximately 16½ years from January 1995, growth in Westminster outstripped that in West Sussex. A rational investor would base his estimate of future price movements on what had happened in the past.

(3) It was sensible of Mr Pridell to adopt a similar approach to that which had been accepted by the Tribunal in *Zuckerman*, and merely substitute the available local information relating to this case for that covering the West Midlands and Kelton Court. It would be prohibitively expensive if lessees were required to produce more information than Mr Pridell had done in order to justify a departure from the *Sportelli* deferment rate.

(4) The hypothetical investor would carry out limited investigations when deciding on the likely growth prospects. He would be unable to find evidence covering the previous 50 years. He would form part of a market comprising well-informed purchasers, intending to hold the Property for a reasonably long term. Such a purchaser would conclude that an investment in Horsham would be likely to produce a lower rate of capital growth than in PCL.

Conclusions – the burden of proof

34. Each party sought (although only faintly) to establish a forensic advantage by reference to their respective status in this appeal on the basis of the following submissions:

(1) On behalf of the Appellant Mr Cowen submitted that, although this is the Appellant's appeal, the appeal is by way of rehearing and therefore this Tribunal must adopt the *Sportelli* deferment rate (subject to the 0.25% addition for obsolescence which is not the subject of the present appeal) unless sound reasons, based upon evidence, for any departure from such rate have been produced by the Respondent.

(2) Mr Radevsky on behalf of the Respondent submitted that this is the Appellant's appeal (albeit by rehearing and not by review) and that this Tribunal should only disturb the LVT's decision if persuaded that such decision is wrong – which is a conclusion this Tribunal should not lightly reach.

35. We conclude the proper approach is this. This is an appeal by way of rehearing. We have received valuation evidence. We should have as our starting point the 5% deferment rate determined in *Sportelli*. That rate comprises three elements: a risk free rate of 2.25% from which a rate of real growth of 2% is deducted and to which a risk premium of 4.75% is added. The question is whether, on the evidence, any of those elements require adjustment. In reaching conclusions on these points we should accept the factual findings of the LVT (in so far as those are not challenged in this appeal); we should accept that an addition of 0.25% to the deferment rate is to be made and is justified in respect of obsolescence (because this aspect of the LVT's decision is not subject to an appeal – permission to challenge this point having been refused); and we should have regard to the reasoning of the LVT upon the other points. However it is for this Tribunal, proceeding as aforesaid, to decide whether on the evidence the deferment rate requires further adjustment upwards from 5.25% .

Conclusions - management

36. We consider first the LVT's conclusion that 0.25% should be added to the deferment rate in respect of management problems.

37. Paragraphs 95 and 96 of *Sportelli* are set out at paragraph 11 above. The Lands Tribunal there concluded:

(1) A distinction should be made in the deferment rate between reversions upon houses and reversions upon flats because of the management problems associated with flats;

(2) It is not appropriate to differentiate between flats that are the subject of head leases and those which are not – the potential for management problems to arise is inherent in all leases, which is why a standard adjustment is appropriate;

(3) The management concerns are not necessarily so much less for a single flat than for a block to warrant a different adjustment;

(4) Because what is under consideration is a long-term investment it is the prospect of management problems arising during the course of the tenancy that is the important consideration rather than the state of affairs at the time of valuation; and

(5) It is possible there could be a case for an additional allowance where exceptional difficulties are in prospect, but that would need to be the subject of compelling evidence.

38. It is important to remember that the purpose of the deferment rate is that it is an annual discount of a future receipt, namely the vacant possession value of the flat at a future date. If a feature of a flat (whether positive or negative) or of the block containing the flat is fully reflected in the vacant possession value of the flat, it would be double counting for the same feature also to be used as justifying a downwards or upwards adjustment to the deferment rate, unless there was clear evidence to justify such a course.

39. We accept the LVT's description of the Property and of Bishopric Court and we accept that, as at the valuation date, the management account appears to have had a bank loan and was somewhat overdrawn. There was also evidence that as at that date there was a trend of increasing service charge arrears. However, we do not consider that it can be said in the present case that at the valuation date there were exceptional management difficulties in prospect (as contemplated in paragraph 96 of *Sportelli).* Certainly there is no compelling evidence of such exceptional management difficulties. Mr Pridell accepted that there was no evidence in the present case such as existed in the *Ashdown* case (see paragraph 29 of the decision in that case).

40. It seems to us self evident that the value of the long leasehold (or freehold) of a flat will be affected by whether on the one hand the building containing it is well maintained and managed with no present or prospective management problems, or whether on the other hand the building is poorly maintained and managed with present and/or prospective management problems. We did not understand Mr Pridell to give us any (or at least any significant) evidence to the effect that in the present case such management problems as may have existed or been in prospect at Bishopric Court as at the valuation date were not already fully reflected in the vacant possession value of the Property. On this point we accept Mr Sharp's evidence that all the defects in the Property and problems for the future are wrapped up in the vacant possession value.

41. While we were not referred by the parties to the case next mentioned we note that in *Cik v Chavda* (LRA 111/2007, unreported), the Lands Tribunal (George Bartlett QC, President and P R Francis FRICS) stated at paragraph 32:

> "Further factors were identified by the LVT in five bulleted points. They were: the continuing history of litigation between landlord and tenants about services and charges; the 'very poor tenants' that made up half the occupancy of the flats; the poor external condition of the premises; noise from the A3006 Bath Road and the overhead flight path: and the flanking road to the industrial estate to the rear. In the light of *Sportelli* the correct approach

> when considering matters of this sort is to ask whether or not they are fully reflected in the vacant possession value. If the evidence shows that they are not fully reflected – if they would be of greater concern to the purchaser of the reversion than to the purchaser of the freehold with vacant possession – an adjustment to the risk premium might be justified. We cannot in principle see why such adverse factors as these are not fully reflected in the freehold vacant possession value, and there is nothing in the evidence to suggest that they are not. All of them seem to us to be pre-eminently matters in respect of which a purchaser of the freehold with vacant possession, who proposed either to occupy or to let the flat and expected at some time in the future to sell it, would be concerned to make appropriate allowance in determining how much he was prepared to pay. We can see no reason why the notional purchaser of the reversion, basing himself on this vacant possession value, would make an addition to the deferment rate because of these factors."

We agree with this analysis which we consider to be equally applicable in the present case.

42. Accordingly we do not consider that evidence regarding the particular characteristics of the Property or of Bishopric Court as described by the LVT (see paragraph 2 above) even coupled with evidence that as at the valuation date there was an overdrawn service charge account with a bank loan and increasing arrears of service charge payments, is sufficient to justify an increase in deferment rate. We cannot see why all such matters are not already fully reflected in the freehold vacant possession value of the Property.

43. There is however a separate argument we must consider based upon *Zuckerman* and the finding there that by the valuation date relevant in that case (September 2007) the market was more aware of the dangers posed by the 2003 Regulations than was the case in *Sportelli*, where the properties fell to be valued substantially earlier. This led the Tribunal in *Zuckerman* to conclude that investors would have required an addition of 0.5% above the rate for houses (not merely 0.25% as applied in *Sportelli*) to reflect the greater management problems associated with flats than with houses. In summary the Tribunal was recognising in *Zuckerman* that the responsibility of ownership of a reversion on a block of flats (as compared to the ownership of a reversion upon a single dwelling house) is more burdensome than was recognised in *Sportelli*.

44. Upon this point Mr Sharp gave evidence as summarised above to the effect that the market had taken the 2003 Regulations in its stride and that now management was conducted along tramlines and that in fact management was now easier and more efficient than in 1982. However, whilst that may be Mr Sharp's personal experience, we accept the evidence of Mr Pridell that within the many applications made to leasehold valuation tribunals generally (and to this LVT in particular) there are a substantial number of cases where landlords and tenants are embroiled in service charge disputes regarding consultation under section 20 of the Landlord and Tenant Act 1985 as amended and the 2003 Regulations. Since the valuation dates in *Sportelli* the potentially draconian effect of the legislation has become more widely recognised. In paragraph 53

of its decision the LVT drew attention to the decision of the Lands Tribunal in *Daejan v Benson*, where the Tribunal made reference to:

> "… the potential effects – draconian on the one side and a windfall on the other – are an intrinsic part of the legislative scheme."

This decision (a decision of the Tribunal whose constitution included the Senior President and which was subsequently upheld in the Court of Appeal) was given in November 2009, i.e. some four months before the valuation date in the present case. (Permission has been granted for a further appeal to the Supreme Court).

45. In our judgment those investing in freehold reversions upon flats would as at the valuation date have had a raised concern about possible management problems during the course of the tenancy, i.e. raised above the level of concern recognised in *Sportelli*. This raised level of concern would have arisen from the 2003 Regulations and from their subsequent interpretation and application especially in a case such as *Daejan v Benson*. This raised concern would have led a hypothetical purchaser of a freehold reversion upon flats to adjust the 4.75% deferment rate (i.e. the *Sportelli* rate for houses) in accordance with the analysis in the following paragraph.

46. We consider that the adjustment to be made to the deferment rate (i.e. an adjustment above the 4.75% deferment rate in respect of reversions upon houses) in order to allow for the management risk attendant upon reversions upon flats is as follows:

(1) There should be an addition of 0.25% (whether or not a head lease exists) as allowed for in *Sportelli*. This 0.25% is a reflection of the fact that a purchaser of a reversion would require an uplift in the deferment rate to reflect the lack of certainty that the purchaser would not become involved with any management problems. Certainty exists where the reversion is upon a dwelling house, but it does not exist where a reversion is upon flat(s).

(2) There should be an addition of a further 0.25% to the deferment rate to reflect the potential actual burden of management (taking into consideration the 2003 Regulations) which will fall upon the purchaser or which may in the future fall on the purchaser during the course of the lease. We consider the analysis in *Zuckerman*, as summarised in para 43 above, to be correct.

(3) However if there exists clear evidence showing that the purchaser of the freehold reversion would realise, upon the facts of the particular case, that it was extremely improbable that, as freeholder, it would ever become burdened with any responsibility of management, then this evidence may well be sufficient to displace this additional 0.25% (such that only the extra 0.25% as allowed in *Sportelli* should be added).

(4) The existence of a head lease and the nature of such head lease and of the head lessee will be relevant upon the point referred to in sub-

paragraph (3) above. On the facts of the present case, where the Appellant (as freeholder) originally gave the landlord's covenants to be responsible for the repair and maintenance of Bishopric Court, we conclude it cannot be said that there is clear evidence which would persuade the purchaser of the freehold that it was extremely improbable the purchaser would ever, during the course of the lease, become burdened with any responsibility for management. We are confirmed in this conclusion by the evidence in the present case that the head lessee pays more rent under the head lease than it receives, coupled with the fact that there is no evidence before us to show that the head lessee can be relied upon for the remainder of the lease to discharge properly all its obligations under the head lease. There is in our judgment a real risk the head lessee may in the future fail to do so.

(5) We consider that the observation (obiter) at the end of paragraph 56 in *Zuckerman* should be understood in accordance with the analysis mentioned in sub-paragraphs (3) and (4) above. Thus the extra 0.25% should not be added to the deferment rate if there is clear evidence the purchaser of the freehold reversion would realise on the facts of the case that it was extremely improbable it would ever become burdened by responsibility for any management. The existence of a suitably worded head lease and suitably solid head lessee, coupled with evidence showing there was no reason to believe the head lessee would ever fail in its obligations, may be sufficient to justify the conclusion, consistently with sub paragraph (3) above, that the extra 0.25% should not be added. However the mere fact of the existence of a head lease is not sufficient to justify the conclusion that the extra 0.25% should be omitted from the deferment rate.

47. Accordingly we conclude that the adjustment to be made in the present case to the 4.75% deferment rate (i.e. the *Sportelli* rate for houses) to reflect potential management problems is 0.5%, which is the adjustment made by the LVT. We do not consider that the fact that the deferment rate has already been adjusted upwards by 0.25% in respect of obsolescence provides any reason for not making this 0.5% adjustment. The adjustment for obsolescence is an adjustment to reflect potential adverse effects upon value having regard to the potential state of the Property and of Bishopric Court at the end of the lease, whereas the adjustment for management is dealing with a different matter, namely potential problems for the freeholder during the lease.

Conclusions – capital growth

48. We now turn to our conclusions upon whether the deferment rate should be increased to reflect any difference in the prospect of long term growth between PCL and Bishopric Court (in West Sussex).

49. For reasons which we give later, we do not consider that evidence extending back as far as 50 years would necessarily be required to persuade an investor that long-term growth prospects were weaker in Horsham than in PCL such as to justify an increase in the deferment rate above the *Sportelli* rate. In our opinion, however, a more careful analysis of the position is required than that suggested by Mr Pridell.

50. In *31 Cadogan Square Freehold Ltd* and 37 *Cadogan Square Freehold Ltd v The Earl Cadogan* [2010] UKUT 321 (LC), 16 September 2010 (unreported), the Lands Tribunal (H.H. Judge Huskinson and A J Trott FRICS) was required to determine the appropriate method of calculating the premium payable on collective enfranchisement. One of the issues raised at the hearing was the proper approach to be adopted by the Tribunal when assessing the attitude of the potential purchaser of the freehold reversion. Having considered judgments of the Court of Appeal in *Inland Revenue Commissioners v Clay* [1914] 3KB 466, *Lady Fox's Executors v Commissioners of Inland Revenue* [1994] 2 EGLR 185 and *Railtrack Plc v Guinness Ltd* [2003] 1 EGLR 2004, the Tribunal concluded at para 83 that:

> "It is the best price reasonably obtainable which we are required to assess and the hypothetical purchaser is prudent rather than rash."

51. It is also clear from that case and the cases there cited that the hypothetical purchaser will act knowledgeably. Accordingly we are unable to accept Mr Pridell's analysis that the price to be paid should be assessed on the basis of what a person performing "almost a back of a fag packet approach" would pay. No doubt there will be hypothetical purchasers in the market who will not make any more sophisticated analysis of the value of the prospective investment beyond this "back of a fag packet approach" and who will in consequence take a more superficial view of the evidence available and will limit their bid by reason of requiring a higher deferment rate to reflect what they may perceive as less good long-term growth in Horsham as opposed to PCL. However the market will also include hypothetical purchasers who are knowledgeable and prudent and who will cast their bid having performed a more careful analysis – it is this more careful analysis that will lead them to decide that an adjustment is not required to the deferment rate because there is no substantial evidence of less good long-term growth in Horsham as compared with PCL. It is from this latter category of hypothetical purchasers that the successful purchaser will come because such a purchaser will bid more than the hypothetical purchaser who adopts Mr Pridell's approach.

52. Although the present appeal is concerned with the extended lease of a single flat rather than the acquisition of the freehold interests in two blocks of flats, there is in our judgment no reason to adopt a different approach to the assessment of value in this case from that in *31 Cadogan Square*.

53. The decision in *Hildron* was dated 10 January 2008. At para 39 the Tribunal (HH Judge Reid QC and N J Rose FRICS) said that in order to justify a departure from the *Sportelli* starting point on the grounds of a difference in growth rates a period in the region of 50 years should be looked at, that statistics with different starting dates should be considered and that the period of 13 years relied upon by the appellant landlord's valuer was inadequate.

54. In *The Holt*, 2 May 2008, the Lands Tribunal (HH Judge Huskinson and A J Trott FRICS) decided (para 81) that the landlord's surveyor's evidence, based on statistics over a period of 15 years starting in a weak market, did not come close to satisfying the criteria identified in *Hildron* as being necessary for a reliable comparison of long term growth rates.

55. In *Zuckerman*, dated 18 November 2009, the Lands Chamber (N J Rose FRICS) concluded at para 49 that the statistical information needed to compare price movements in the West Midlands and PCL over the 50 year period to 2008 was simply not available. It nevertheless went on to find that the available statistical information demonstrated that the difference between past long term rates of price increases in PCL and the West Midlands had been considerable. In the light of that evidence the Tribunal accepted the opinion of the tenants' valuer that this information would have persuaded an investor that he could reasonably anticipate significantly slower long-term growth from residential properties in the West Midlands than in PCL and it found that there was no reason to suppose that the position would have been significantly different in the case of Kelton Court.

56. The conclusions we draw from these decisions are the following. In order to assess long-term growth trends one should ideally look for evidence extending back 50 years and consider different starting dates. Evidence of prices over a period of only 13 or 15 years is inadequate to indicate the long term position. Where information covering more than 15 years but less than 50 is available it might, depending on the length of time and the particular circumstances, be sufficient to indicate a trend which an investor would consider produced a reliable guide to future performance.

57. In *Zuckerman* the Tribunal found that there had been a consistent pattern of price movements in the West Midlands from 1973 to 2008 (Nationwide) and from 1983 to 2008 (Halifax) and that a similar pattern had applied in the subject block of flats in Edgbaston between 1974 and 2008. This consistent pattern, based on statistics ranging variously over 25,34 and 35 years, all pointed to significantly lower growth in the West Midlands than had been seen in PCL over 32 years (Knight Frank).

58. By contrast, the evidence of growth which has been put forward in this appeal is very thin. Like Mr Rutledge in *Zuckerman*, Mr Pridell relied on the Knight Frank graph for PCL to show price movements there over a 32 year period. For the purpose of illustrating similar movements in Horsham, he relied on figures over 19 years, not in

West Sussex but for the entire Outer Metropolitan area (Nationwide). He also produced sale prices in Bishopric Court over 26 years, but in cross examination he accepted that only the figures for the last 11 years were of real significance. In our view the evidence of market movements in Horsham which has been produced in this appeal is of scarcely more assistance than that which was rejected by the Tribunal in *The Holt*. It is insufficient to persuade us that there was at the valuation date a prospect of significantly slower growth in values in Horsham over the long term than in PCL. (We would observe that, at our request, Mr Pridell produced a copy of the graph which had been presented by Mr Rutledge in *Zuckerman*. Although in paragraph 50 of that decision the Tribunal described the Knight Frank Index since 1976 as referring to Kensington and Chelsea, it appears from the graph that it in fact related to Prime Central London).

59. For completeness we should record that Mr Pridell's graph also showed the Halifax index of prices in Kensington and Chelsea over the 16 years from 1992 to 2008. This evidence was produced in *Zuckerman* but the Tribunal decision in that case did not suggest that it added materially to the information provided by the Knight Frank graph over a much longer period. Similarly, Mr Pridell reproduced information put forward in *Zuckerman* relating to house prices generally in the UK from 1952 to 2008 (Nationwide) and all flats in London from 1973 to 2008 (Nationwide). Again, this information was not specifically mentioned in the Tribunal's conclusions in *Zuckerman*, and we do not find it to be of relevance to the present exercise. Nor do we consider that Mr Sharp's comparison of values in West Sussex and Westminster over the 15 years prior to the valuation date covers a period of sufficient length to enable any useful conclusions to be reached. However, it may be noted that over the period from January 1995 to December 2005 the increase in both indices was effectively the same (100 became 277 in West Sussex and 276.2 in Westminster).

60. We would add that in our judgment the article in the Financial Times to which Mr Sharp referred is of no help when assessing the market's perception of future growth prospects on the valuation date, some eighteen months before the article was published. Nor in our view does the information Mr Sharp provided regarding extended lease lengths and expensive improvements in Bryanston Square serve to detract from such limited assistance as is to be obtained from the comparative data on Westminster and West Sussex.

61. It is appropriate for us finally to note that all of the evidence and argument upon whether an adjustment should be made to the deferment rate in respect of growth was directed towards the question of whether there could be found a long-term difference in growth rates between Horsham and PCL. It was this comparison that was concentrated upon. No evidence was called nor was any argument advanced upon the question of whether, ignoring wholly growth rates in PCL, the statistical information showed that the real growth rate in respect of flats in Horsham had (over any particular period) been at 2% or had exceeded or fallen short of 2%, which was the real growth rate assumed to be present in *Sportelli*.

Result

62. The appeal on the issue of capital growth is allowed. The appeal on the issue of management is dismissed. The premium payable to City and Country Properties Ltd for a new lease of the Property is £10,762, based on a deferment rate of 5½% (Appendix 2). Neither party made any application for costs and we make no order on the subject.

Dated 17 July 2012

His Honour Judge Nicholas Huskinson

N J Rose FRICS

APPENDIX 1

25 Bishopric Court, Horsham, West Sussex, RH12 1TH

Calculation of lease extension premium by LVT

25 Bishopric Court, Horsham			**Statutory Lease Extension**
Valuation Date	29 March 2010		
Freehold Value	£126,250.00		
Tenant's Improvements	£ nil		
Value of extended lease (unimproved)	£125,000.00		
Freehold Reversionary Value uplift	1%		
Value of existing lease (unimproved)	£108,575.00		
Yield, Ground Rent	7%		
Deferment Rate	6%		
Unexpired term at valuation date	66 years		
New lease term (plus 90 years)	156 years		
Ground Rent	£90.00 for 33 years		
Then	£120.00 for remaining 33 years		
Diminution in value of Landlord's present interest			
Head Lessee			
Agreed Amount	£1,312.00		
Head Lease Reversion	£ nil		£ 1,312.00
Freeholder			
Reversion to Freehold Value	£126,250.00		
PV £1 in 66 years @ 6%	0.0213704	£2,698.01	
Less value of Landlord's proposed interest	£126,250.00		
PV £1 in 156 years @ 6%	0.0001128	14.24	£ 2,683.77
			£ 3,995.77
Plus Landlord's share of marriage value			
Capital value of extended lease	£125,000.00		
Landlord's proposed interest	14.24	£125,014.24	
Less			
Capital value of existing lease	£108,575.00		
Landlord's present interest	£ 3,995.77	£112,570.77	
Marriage value		£12,443.47	
Landlord's share, 50%			£ 6,221.74
Lease Extension Premium			£10,217.51
To Head Lessee			£ 1,312.00
To Freeholder			£ 8,906.00
			£10,218.00

APPENDIX 2

25 Bishopric Court, Horsham, West Sussex, RH12 1TH

Calculation of lease extension premium by the Upper Tribunal (Lands Chamber)

Valuation Date	29 March 2010		
Freehold Value	£126,250		
Tenant's Improvements	£ nil		
Value of extended lease (unimproved)	£125,000		
Freehold Reversionary Value uplift	1%		
Value of existing Lease (unimproved)	£108,575		
Yield, Ground Rent	7%		
Deferment Rate	5½%		
Unexpired term at valuation date	66 years		
New Lease term (plus 90 years)	156 years		
Ground Rent	£ 90.00 for 33 years		
Then	£120.00 for remaining 33 years		
Diminution in value of Landlord's present interest			
Head Lessee			
Agreed Amount	£ 1,312		
Head Lease Reversion	£ nil		£1,312
Freeholder			
Reversion to Freehold Value	£126,250		
PV £1 in 66 years @ 5½%	0.03	£3,787	
Less value of Landlord's proposed interest	£126,250		
PV £1 in 156 years @ 5½	0.00024	£ 30	£3,757
			£5,069
Plus Landlord's share of marriage value			
Capital value of extended lease	£125,000		
Landlord's proposed interest	£ 30	£125,030	
Less			
Capital value of existing lease	£108.575		
Landlord's present interest	£ 5.069	£113,644	
Marriage value		£ 11,386	
Landlord's share, 50%			£ 5,693
Lease Extension Premium			£10,762
To Head Lessee			£ 1,312
To Freeholder			£ 9,450
			£10,762