UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – price – rent review clause – whether reviewed rent to be a "modern ground rent" s.15(2) Leasehold Reform Act 1967 – whether rent must be a "marketable" rent – presumption of reality – alternative valuations agreed – appeal dismissed

IN THE MATTER OF AN APPEAL FROM A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE WALES

BETWEEN:

CLARISE PROPERTIES LIMITED **Appellant**

AND

(1) RACHEL EMILY REES **Respondents**
(2) JAMES JOHN REES

Re: 115 Pantbach Road
Cardiff CF14 1TX

Before: Martin Rodger QC, Deputy President

Sitting at: 43-45 Bedford Square, London WC1B 3AS
on
1 September 2014

Mark Loveday, instructed by S E Law Limited, on behalf of the Appellant
Barry Denyer-Green, instructed by The William Ricketts Partnership, on behalf of the Respondents

The following cases are referred to in this decision:

Arrowdell Limited v Coniston Court (North) Hove Limited [2007] RVR 39

Basingstoke & Dean Borough Council v The Host Group [1988] 1WLR 348

Dennis & Robinson Ltd v Kiossos Establishment [1987] 1 EGLR 133

Farr v Millersons Investments Limited (1971) 22 P&CR 1055

Gajewski v Anderton [1971] RVR 199

Plotnek v Govan [2014] UKUT 0322 (LC)

DECISION

Introduction

1. This appeal is against a decision of the Leasehold Valuation Tribunal for Wales ("the LVT") given on 19 September 2013 in which it determined a preliminary issue arising out of a claim to acquire the freehold of a semi-detached house at 115 Pantbach Road, Cardiff ("the Property") under the Leasehold Reform Act 1967 ("the 1967 Act"). The claim was brought by the Respondents, who are the tenants of the Property, against the Appellant, which is their landlord. The preliminary issue concerns the effect of a rent review clause in the Respondents' lease which, but for completion of the enfranchisement, will be used to determine the rent payable for the Property by the Respondents from 2015 onwards

2. The Respondents' lease is for a term of 99 years from 24 June 1990 and was granted on 7 June 1991 by Burford Estate & Property Company Ltd to Nita Casey and Sylvia Airey in substitution for a previous lease which had been granted to their father. A premium of £600 was paid for the new lease and it is common ground that both the premium and the ground rent of £45 a year payable for the first 25 years of the term were nominal sums.

3. The new lease was granted following the death of a previous long lessee. The previous lease had been granted in the 1920s and, as it was now too short to be mortgageable, could not readily be sold by the personal representatives of the deceased lessee; nor were the personal representatives (in whom the lease had become vested) in a position to acquire the freehold under the 1967 Act as they did not satisfy the qualifying conditions which then applied. A negotiation therefore took place which led to the grant of a new lease for a long term at a very modest premium and ground rent, but with a rent review clause.

4. Clause 1(b) of the lease provides for the rent of £45 a year to be reviewed in 2015 on the 25th anniversary of the commencement of the term, and again on the 50th and 75th anniversaries. The new rent is to be:

> "… such annual rent (being not less than the rent payable immediately prior to each relevant Rent Review Date) being a sum representing the open market letting value of the land hereby leased as if it were a vacant site without any buildings thereon ("the Site") to be assessed in accordance with current open market values of the Site at each relevant Rent Review Date when the said site shall fall to be re-assessed as if it were at such Rent Review Date available for residential development for purposes authorised by the Town and County Planning Act …"

In the event of disagreement the reviewed rent is to be determined by a Chartered Surveyor acting as an expert or arbitrator.

5. The Respondents gave notice of their claim to acquire the freehold of the Property under Part I of the 1967 Act on 10 September 2011, a little less than 4 years before the first rent review date. The parties agreed that the price payable for the freehold should be determined under section 9(1) of the 1967 Act. It was also agreed that the rent which was due to become payable after the rent review in 2015 was relevant to the assessment of the price: the higher that rent was likely to be, the more valuable would be the landlord's interest and the higher would be the price which the Respondents would have to pay for it. The parties could not agree how the rent review clause ought to be implemented and they therefore agreed to invite the LVT to interpret the clause before they attempted to agree the purchase price.

The statutory context

6. Section 1(1) of the 1967 Act confers on the tenant of a leasehold house a right to acquire on fair terms either the freehold or an extended lease of the house in prescribed circumstances. Although this appeal concerns a claim to acquire the freehold of the Property, the arguments cannot be understood without referring briefly to the terms of the 1967 Act concerning the acquisition of an extended lease.

7. Where a tenant elects to acquire an extended lease, the landlord is obliged by section 14(1) to grant to the tenant in substitution for his existing tenancy a new tenancy for a term expiring 50 years after the term date of the existing tenancy. The terms of that tenancy are prescribed by section 15(1) and are broadly to be the terms of the existing tenancy. Any ground rent payable under the original tenancy remains payable at the same rate for the remainder of the original term, but after the term date of the original tenancy section 15(2) provides for a different rent to become payable.

8. Section 15(2) provides as follows:

> "The new tenancy shall provide that as from the original term date the rent payable for the house and premises shall be a rent ascertained or to be ascertained as follows:
>
> (a) the rent shall be a ground rent in the sense that it shall represent the letting value of the site (without including anything for the value of buildings on the site) for the uses to which the house and premises have been put since the commencement of the existing tenancy, other than uses which by the terms of the new tenancy are not permitted or are permitted only by the landlord's consent;
>
> (b) the letting value for this purpose shall be in the first instance the letting value at the date from which the rent based on it is to commence, but as from the expiration of 25 years from the original term date the letting value at the expiration of those 25 years shall be substituted, if the landlord so requires, and a revised rent becomes payable accordingly;
>
> (c) the letting value at either of the times mentioned shall be determined not earlier than 12 months before that time (the reasonable cost of obtaining a valuation for the purpose being borne by the tenant), and there shall be no revision of the rent as provided by paragraph (b) above unless in the last of the 25 years there mentioned the landlord gives the tenant written notice claiming a revision."

9. A rent determined in accordance with section 15 is often referred to as a "modern ground rent", although the alternative "section 15 rent" is sometimes preferred.

10. The significance of section 15(2) for the purpose of a case such as this, in which the tenants do not claim an extended lease but instead wish to acquire the freehold of the Property, is that the price payable for the freehold in accordance with section 9(1) of the 1967 Act is the amount which the house and premises might be expected to realise if sold in the open market on the assumption, if the tenancy has not in fact been extended under the Act, that it was to be so extended. The freehold to be valued is therefore taken to be subject to a lease under which the original ground rent will be payable for the duration of the existing tenancy, after which a ground rent determined in accordance with the section 15(2) is assumed to

be payable for a further 50 years. The extended lease is purely notional, as no such lease is granted in reality, but the assumed extension is nonetheless an important feature of the valuation hypothesis by which the price for the freehold is to be determined.

11. In order to determine the price payable for the freehold a valuer must therefore form a view of the level of rent which would notionally be expected to become payable in accordance with section 15(2) if the lease had been extended.

12. Section 15(2) requires the ascertainment of "the letting value of the site" assuming nothing is to be paid for the value of buildings on it, but it does not prescribe any detailed method of valuation by which that letting value is to be ascertained. Moreover, as the authors of *Hague on Leasehold Enfranchisement* (2014, 6th Ed) point out at paragraph 8-06, no modern landlord would ever let a development site for a term of 50 years with a single rent review after 25 years except where obliged to do so by the 1967 Act. There is therefore no evidence of comparable open market lettings which may be utilised by a valuer to determine the section 15 rent.

13. Because of the absence of open market evidence, a valuation convention has evolved. That conventional approach to ascertaining the section 15 rent equates the rent with the rate of return which a freeholder could achieve on the capital value of the site if it was let on a 50 lease. In adopting it the valuer first ascertains the capital value of the site on the assumption that it is free of buildings and available for development. Having arrived at that capital value the letting value of the site is ascertained by decapitalising the site value at an appropriate rate intended to reflect the rate of income return which a freeholder might expect to achieve on the grant of a 50 year lease of the site with a single rent review after 25 years for the uses described in section 15(2).

14. In order to undertake this exercise it is first necessary to establish the value of the site. Three different approaches to valuing the site have been employed. These were identified and discussed in *Farr v Millersons Investments Limited* (1971) 22 P&CR 1055, a decision of the Lands Tribunal (RC Walmsley FRICS) in the relatively early years of enfranchisement valuation. The first is the "standing-house approach" which seeks to derive the site value by taking a proportion of the "entirety value" i.e. the value of the whole property including the buildings standing on it on the assumption that that property has been modernised and is in good condition. Alternatively the land may be valued on a "cleared-site" basis by reference to prices payable for comparable sites for development, where evidence of such sales is available. A third little-used approach referred to as the "new-for-old approach" takes a proportion of the value of the land determined by a residual valuation assuming that a new building was to be substituted for the existing building. None of these approaches is without difficulty both in practice and in principle, as the discussion in *Hague* at paragraphs 8-07, 8-11 and 8-12 explains.

15. The passage of time has not weakened the force of the Lands Tribunal's observation in *Farr* (at 1061) that it is impossible to regard any of these alternative approaches as the right method or a wrong method of valuation. They are different valuation techniques which may be applied as the available evidence permits, as steps in the process of ascertaining a section 15 ground rent. It is always necessary to remember, however, that the object of employing any of these approaches is to determine a letting value i.e. a rent which would be paid on a letting of the property.

The proceedings before the LVT

16. No single question was formulated by the parties or by the LVT as representing the preliminary issue on which it was required to rule. What the parties really wanted was guidance on the most appropriate method of valuation to be use when they sought to determine the rent which would become payable after the first rent review in 2015. That rent would be payable for the remainder of the term of the current lease and the capitalised value of that income stream was potentially an important component of the price payable for the freehold under section 9(1) of the 1967 Act.

17. The case presented to the LVT on behalf of the Appellant proposed that the rent payable under the existing tenancy from the first and second rent review dates was to be determined, in the absence of agreement, by adopting the same valuation approach as is conventionally adopted to determine a section 15 rent. That was said to be the effect of the direction that the annual rent payable from each review date was to be a sum "representing the open market letting value of the land … as if it were a vacant site without any buildings thereon". The further instruction that this letting value was "to be assessed in accordance with current open market values of the Site" required that the value of the site be ascertained by reference to values in the open market and that that site value should then be employed, as in a conventional section 15 valuation, to arrive at an equivalent annual value by de-capitalising at an appropriate assumed rate of return.

18. The position taken by the Respondents before the LVT was that the reviewed rent should be a nominal ground rent. They submitted that, in the open market, ground rents are agreed on a nominal basis simply as an ad hoc financial arrangement to allow a developer an additional return on its investment and to supplement the capital receipt on the grant of the lease; reference was made to observations to that effect by the Lands Tribunal in *Gajewski v Anderton* [1971] RVR 199, 204. It was argued that the direction to assess rental value "in accordance with current open market values" precluded the adoption of a section 15 approach because rents determined on that basis were never encountered in the open market and no comparable transactions were available to aid in the assessment. The only evidence of open market transactions in 1991 and subsequently related to long leases at nominal ground rents and it followed that the parties must have intended that a further nominal sum should become payable from the first review date. Leases at ground rents in excess of nominal rents would be unmortgagable and unsaleable and the parties cannot have intended to alter their relationship so fundamentally at the first review.

19. The LVT was, in effect, invited to choose between the parties' rival submissions without them being reduced to a defined issue.

20. The LVT was not greatly attracted by either of the alternative approaches to valuation urged on it by the parties. It found no difficulty in rejecting the Respondents' contention. The reference to "open market values of the site" demonstrated that what was required was a rent for the site which would be agreed in the open market in return for a lease for a term of 99 years. The rental value could not therefore simply be a nominal figure. The circumstances of the letting in 1991 supported the conclusion that the bargain cannot have been struck for a new lease at a nominal premium on the basis that the landlord would never be entitled to more that a nominal ground rent.

21. At paragraph 61 of its decision the LVT recorded that it raised with both parties the possibility that there may be other interpretations than the "nominal ground rent" or "modern ground rent" positions which they had advanced. At paragraph 62 of its decision the LVT recorded that Mr Loveday, who appeared before it on behalf of the Appellant "accepted that for the valuers to carry out meaningful negotiations and produce their report, it would be necessary to do more than simply declare that the reviewed rent was "nominal" or "modern"".

22. Having decided that the reviewed rent should not simply be a nominal ground rent, and having sought and (as far as it was concerned) obtained the agreement of both parties, the LVT embarked on a discussion of the rent review clause and how it ought to be implemented. That discussion is the main focus of the appeal and it is therefore appropriate for me to set it out fairly fully:

> "63. We have indicated in paragraph 60 above … that the review is not to a "nominal ground rent". We must now consider the meaning of the expression "the open market letting value of the land hereby leased". We appreciate that there is no market as such. There is no evidence of any transactions of this nature. However, the lease envisages a hypothetical market and that is the basis of the valuation process which must be adopted. We have concluded the following.
>
> (a) The expression assumes that the Appellant is willing to lease the land and the Respondents are willing to accept such a lease (see *Kiossos)*.
>
> (b) It also assumes that whilst it may be necessary to depart "in one or more respects from the subsisting terms of the actual existing lease", in general "the parties are to be taken as having intended that the notional letting postulated by their rent review clause is to be a letting on the same terms (other than as to quantum of rent) as those subsisting between the parties in the actual existing lease" (*per* Nicholls LJ in *Basingstoke* at p.354). The hypothetical lease for the purpose of calculating the rent is to be taken as being on the same terms as the Lease except in respect of the rent. It will take into account, therefore, that the letting is at a premium of £600 and that there are to be rent reviews after 25, 50 and 75 years. The issue of the premium was referred to during evidence. Mr Cooper regarded the premium as equating to a difference in the ground rent of £42 pa when taken over the full term of the lease. Mr Evans took the view that the amount was so small as to be insignificant in valuation terms.… In our view, the premium, although relatively small, could well have some slight bearing on the rental payable. After all, as both valuers agreed, the level of a premium will affect the level of the rent.
>
> (c) It will be necessary to consider the current open market value of the land. The draftsman has in fact used the word "values" in the plural. This suggests to us that the valuation exercise needs to be by reference to the sale values of plots of land rather than by the use of such formulae as the standing house method. Each comparable will suggest a value for the site. Two or more comparables may indicate a spread of values and it is these which need to be taken into account.
>
> (d) Account will also need to be taken of the location of the site as well as its physical constraints. [Various constraints were then mentioned including planning restrictions and the proximity of adjoining buildings]. These points are not meant to be comprehensive, merely indicative.

(e) The "open market letting value" means precisely that. The reviewed rent has to be a marketable rent. Upon this issue, we prefer the evidence of Mr Cooper. If the site were placed on the open market for letting only, the only purchasers would be a builder who would wish to build and sell the completed building either by way of underlease or assignment or a self-build purchaser. In either case the ability to fund the purchase is critical. We are satisfied on the evidence that there would be no market for a letting at a section 15 ground rent or at a ground rent akin to that. Potential buyers would be unable to access a mortgage on normal terms. The only buyers that would be in a position to buy therefore would be cash buyers, or those with other sources of funding, willing to take on a diminishing asset with a built-in regular and not insignificant financial commitment. A "modern ground rent" would be a continuous burden both during construction and whilst the builder waited for a buyer to complete. Any purchase of a house at such a ground rent would come at a price, and the amount of discount that the potential buyer would demand would in effect render the whole project unviable or at least so risky that we cannot see any builder willing to enter into such a transaction. Nor would a builder be prepared to take on the Lease and build to let for the reasons already stated.

(f) The question is: what is "the open market letting value of the land"? The answer is: it is a marketable ground rent; the highest ground rent at which a purchaser (builder or otherwise) in the hypothetical open market would be willing to acquire a lease of the plot of land. We would assess it to be more than a "nominal sum" but there will come a point, even in the hypothetical open market, when a cash buyer or one with other sources of borrowing will cease to be willing to take on the commitment particularly as the leasehold interest depreciates over time and there is a prospect of an increase in the ground rent in 25 years."

23. The LVT formed its conclusions on the rent review clause with the benefit of oral evidence from valuers instructed by the parties. The admissibility of some of that evidence was questionable as it included testimony intended indirectly to cast light on the subjective understanding and intention of the parties who entered into the lease in 1991. It also included more helpful evidence concerning the terms on which the leases of sites suitable for development are usually granted, the levels of ground rents on the grant of residential leases, the rarity of houses being the subject of new leases, and other matters on which the experienced witnesses were well qualified to speak.

24. Despite the fact that the LVT entirely rejected the Respondents' case, it was the Appellant which sought permission to appeal. Having considered the proposed grounds of appeal I was concerned that a decision of the Tribunal on the preliminary issue might not bring an end to the proceedings as a whole. I therefore directed that, before permission to appeal would be considered, the parties should either agree, or invite the LVT to determine, alternative valuations on the basis of their respective cases or any alternative case which either of them wished to advance. In the event the parties were able to reach agreement on the price which would be payable on each of their cases and also on the basis of the LVT's approach (which they referred to as a "market" ground rent). By a further decision dated 12 May 2014 the LVT recorded the agreement which had been reached.

25. On the basis that the rent review was to be to a "market" ground rent taking into account the factors identified by the LVT in its original decision, the parties agreed that the premium payable for the

freehold of the Property would be £10,530.00. This figure represented the opinion of Mr Evans, the Appellant's valuer. As he explained in a report dated 14 April 2014, Mr Evans' view of the appropriate ground rent was based on a single piece of evidence: a flat in Cardiff offered for sale at a price of £194,950.00 with a ground rent of £450 p.a. Mr Evans took this ground rent to be "substantially higher than the nominal ground rents proposed by the Respondents" and as reflective of the "market" ground rent which the LVT had had in mind. He then used it to calculate the arithmetical relationship between that ground rent and the asking price of the flat before applying the same ratio to his own standing-house valuation of the Property. This calculation suggested to him that a ground rent of £650 p.a. represented the rent which would become payable following the first rent review in 2015. Applying that ground rent as a component in determining the price of the freehold reversion produced a premium of £10,530.00. The Respondents were prepared to agree that figure.

26. On the Respondents' preferred approach (that the rent review clause required a nominal ground rent, which the parties agreed would be in the order of £180 on the first review) it was agreed that the price payable for the freehold of the Property would be £5,025.00.

27. On the basis that the rent review clause required a valuation based on a conventional section 15 ground rent approach, the parties' valuers considered that the appropriate ground rent would be in the range of £4,500.00 - £5,000.00 a year. On that basis they agreed that a price of £79,352.00 would be payable for the freehold of the Property.

The grounds of appeal

28. The Appellant obtained permission to appeal on 5 grounds, which I can summarise as follows:

(1) That the LVT's approach to valuation had been wrong; in particular its rejection in paragraph 63(c) of the decision of "such formulae as the standing house method" had resulted in a substantial and unjustified discount on the rent which would have been appropriate if the conventional approach to ascertaining a section 15 rent had been adopted.

(2) That the LVT had been wrong to conclude that the reviewed rent had to be a "marketable rent" and to reject the Appellant's valuation approach on the grounds that "there would be no market for a letting at a section 15 ground rent or at a ground rent akin to that." It was common ground that there was no market for a letting of the site on the assumptions required by clause 1(c) of the lease irrespective of how the clause was interpreted, so the absence of a market for lettings at a section 15 ground rent was no reason not to interpret the clause as requiring a rent at that level.

(3) That the LVT had been wrong to limit the "marketable ground rent" as it did in paragraph 63(f) of its decision by reference to the highest ground rent which a purchaser in the hypothetical open market would be willing to agree to acquire a lease of the plot of land. It was said that the LVT had not heard argument on that basis and that its conclusion involved a substantial procedural irregularity.

(4) That the LVT had been wrong in law to assume, as it did in paragraph 63(b) of its decision, that the "presumption of reality" required that the terms of the hypothetical letting by reference to which the reviewed rent was to be ascertained should be taken to include payment of a premium of

£600 and rent review's after 25, 50 and 75 years. It was said that neither party had addressed this suggestion in evidence or argument.

(5) That the LVT had not been entitled to give guidance on site specific factors relevant to the valuation exercise because those factors had not featured in the arguments or evidence advanced at the hearing.

29. At the hearing of the appeal the main grounds advanced by Mr Loveday were more limited than those for which permission had been granted. In particular he did not direct his argument to grounds (4) and (5) in the list above.

30. The Respondents had initially indicated an intention to seek permission to cross appeal the LVT's rejection of their case that the reviewed rent should be a nominal ground rent, but after agreement was reached on the alternative valuations in paragraphs 25 to 27 above the Respondents accepted that the LVT had been right to reject their argument. On the appeal the Respondents argued simply that the LVT had been entitled to give the guidance which it did in paragraph 63 of its decision and in particular to emphasise that the rent payable on review had to be a rent which would be agreed in the open market.

31. Before considering the grounds of appeal in greater detail I should point out that, when it refused permission to appeal the LVT provided a commentary on its decision in order to make clear why it considered the Appellant's complaints were unjustified. Mr Denyer-Green made reference to that commentary in his statement of case for the appeal, but Mr Loveday objected to me taking it into account and submitted that the LVT was not entitled to supplement its original decision with further reasons. I have not found it necessary to consider the LVT's reasons for refusing permission to appeal when deciding the issues raised before me so I make no further reference to them.

Procedural irregularity

32. Mr Loveday's most general complaint, permeating most of his grounds of appeal, was that the LVT had been guilty of a serious procedural irregularity by discussing matters in its decision which had not been the subject of argument. He submitted that before the LVT was entitled to construe the lease in a manner not advanced by either side it was essential that it expose its proposed interpretation to the parties for their comment.

33. Mr Loveday's criticism was based on the well known warning given by the Lands Tribunal in *Arrowdell Limited v Coniston Court (North) Hove Limited* [2007] RVR 39 at paragraph 23:

> "It is entirely appropriate that, as an expert tribunal, an LVT should use its knowledge and experience to test, and if necessary to reject, evidence that is before it but there are three inescapable requirements. Firstly, as a Tribunal deciding issues between the parties, it must reach its decision on the basis of evidence that is before it. Secondly, it must not reach a conclusion on the basis of evidence that has not been exposed to the parties for comments. Thirdly, it must give reasons for its decision."

34. It is axiomatic, as *Arrowdell* illustrates, that a fair procedure requires that the parties should be able to make submissions on any specific matters which subsequently form the basis of its determination. There is, however, a distinction between a tribunal reaching a decision on the basis of evidence not adduced by the parties and on which they have not had the opportunity to comment, and a tribunal arriving at a conclusion on the meaning of a document which falls someway between the alternative submissions made by professional advocates who appear before it. In this case both parties were represented by experienced counsel who submitted opening and closing arguments both orally and in writing in the course of a hearing which lasted 2 days. The focus of that hearing was a relatively narrow point and the LVT was entitled to assume that the advocates had addressed it on all of the points on which they considered it was necessary for submissions to be made. The LVT recorded specifically in its decision that it had raised with the parties the possibility that there may be other interpretations of the language of the rent review clause which fell somewhere between the extremes for which they argued. Even if that observation had not been made, it was self evidently the case. Both parties were forewarned, therefore, and had the opportunity to make any alternative or additional submissions which they considered appropriate before the LVT provided the assistance to the valuers which it was specifically invited to provide.

35. It was, in my judgment, entirely appropriate for the LVT to approach its task in the discursive manner which it adopted in paragraph 63 of its decision. It would have been a dis-service to the parties for it to limit its conclusion to a rejection of the nominal ground rent case advanced by the Respondents and the section 15 methodology proposed by the Appellants. In the event, as the LVT made clear when it rejected the Appellant's application for permission to appeal on this ground, and as the written arguments with which it was presented demonstrate, the suggestion that the LVT was not addressed at least in general terms on the issues on which it commented in its decision does not seem to me to be well-founded. I therefore reject this general criticism of the decision.

Ground 1: The LVT's rejection of valuation formulae

36. Mr Loveday's first substantive argument concerning the LVT's general approach to valuation focused on paragraph 63(c) of the decision. It will be remembered that, after stipulating that the annual rent should be a sum representing the open market letting value of the land as if it were a vacant site without any buildings, clause 1(b) of the lease goes on to require that such value is "to be assessed in accordance with current open market values of the Site at each relevant Rent Review Date". In paragraph 63(c) the LVT pointed out that draftsman had used the word "values" in the plural before continuing:

> "This suggests to us that the valuation exercise needs to be by reference to the sale values of plots of land rather than by the use of such formulae as the standing house method. Each comparable will suggest a value for the site. Two or more comparables may indicate a spread of values and it is these which need to be taken into account."

37. Mr Loveday submitted that the LVT had been wrong to rule out the use of formulae in general and the standing house method of valuation in particular. Both experts had agreed at the hearing that there was no open market evidence of sales of sites so it would be necessary to use formulae such as the standing house method to arrive at the rental value. The parties must have envisaged such a method of valuation as it was in common use in 1991 and it must have been obvious to them that there were unlikely

to be any proper comparables. The use of the plural form, "values", was explained because the value of the land had to be determined on three separate occasions, in 2015, 2040 and 2065.

38. I do not think there is anything of significance in this ground of appeal.

39. The LVT prefaced its remarks quoted above by stating that "it will be necessary to consider the current open market value of the land". What follows in paragraph 63(c) is its understanding of how that should best be done. Its conclusion that the value of the land is to be ascertained by reference to the sale values of plots of land is consistent with the language and intent of clause 1(b). The LVT referred to the value of "the land", but the expression used in the rent review clause is "the Site". That expression is defined to mean "the land hereby leased as if it were a vacant site without any buildings thereon". Thus, when the clause directs that the open market letting value of the Site is to be assessed "in accordance with current open market values of the Site" it means that it is to be assessed in accordance with current open market letting values of the land comprised in the lease as if it were a vacant site without buildings. The LVT's preference for a valuation by reference to the sale values of plots of land (meaning plots of land without buildings) is therefore a proper reflection of the type of valuation contemplated by clause 1(b).

40. Clause 1(b) assumes that the rental value of the land will be capable of being arrived at by first considering the capital value of the land. As Mr Loveday pointed out, the reference to the "current open market values of the Site" is a reference to its capital value; when the draftsman intends to refer to a letting value he does so expressly. Although the LVT disapproved of "the use of such formulae as the standing house method" that was in addressing the current open market value of the land (which is the subject matter of paragraph 63(c)). The LVT did not rule out the use of a formula to convert the capital value of the Site, assessed in accordance with current open market values at the review date, into a rental value. In particular, its interpretation of clause 1(b) as providing for a valuation by reference to the sale value of plots of land does not rule out the adoption of the second stage of a conventional section 15 valuation, which is common to both the "cleared-site" and the "standing house" method, and which seek to convert the value of the site into a rental value by de-capitalising the site value using the presumed rate of return which the site owner would require if he were to let it for a term of years.

41. The fact that, in 2013, the experts could not find "comparable" cleared sites is of very little significance. The evidence of the experts, as it was recorded by the LVT in paragraph 18 of its decision, was that: "… in 1991 there was no evidence of plot sales at a "modern ground rent" only and that was still the situation today". The experts did not suggest that there was no evidence of sales of plots of land for development, but only that there was no evidence of such sales reserving a modern ground rent. That does not rule out evidence of freehold sales of more or less comparable sites from which would inform an assessment of the capital value of the subject Site. Moreover, even if there were no sales of vacant plots of land in or before 1991 the parties cannot be taken to have assumed that such evidence would not be available at the review dates.

42. Finally, I am inclined to agree with Mr Loveday that the LVT read too much into the use of the plural "values", but I do not think the significance it attached to that quirk of drafting led it into error. I therefore reject the first ground of appeal.

Grounds 2 & 3: The LVT's preference for a "marketable rent" which a purchaser in the hypothetical open market would be willing to agree

43. Mr Loveday addressed his next two substantive grounds of appeal together. These challenged the LVT's description of the rent to be determined under clause 1(b) of the lease as being a "marketable rent" (paragraph 63(e)) and its suggestion that such a rent should be limited to "the highest ground rent at which a purchaser (builder or otherwise) in the hypothetical open market would be willing to acquire a lease of the plot of land."

44. In his skeleton argument Mr Loveday first pointed out that the LVT had expressed itself to be satisfied on the evidence that there would be no market for a letting at a modern ground rent (which the valuers subsequently agreed would be in the order of £4,500 - £5,000 in this case). It was illogical to conclude from that, Mr Loveday submitted, that the ground rent must be a sum, higher than a nominal ground rent, but nonetheless constrained by what would actually be agreed in the open market for a letting of a bare site for 99 years without a premium. There was no evidence of any such letting, and the valuers agreed that a letting on those terms would never take place. It followed, he suggested, that the LVT's conclusion that the Site could not be let at the levels of rent the valuers thought was appropriate to a section 15 rental valuation "gets the parties precisely nowhere" because the same could be said of a letting at its "market" or "marketable" ground rent.

45. Mr Loveday made two further short points in his written material. First, that there would be evidence that leases which had been extended under section 14 were bought and sold, and were therefore "marketable". Secondly, the lease of the Property granted in 1991 had been sold on 2 occasions since its grant (although Mr Loveday acknowledged that the parties may not have appreciated the effect of the rent review provisions).

46. In his oral submissions Mr Loveday argued that the rent review clause did not direct that the new rent should be limited to a figure which would be agreed in the open market. The letting value was to be derived from a capital value, and it was only the capital value which need be determined by reference to transactions in the open market.

47. None of these points seems to me to be of any weight.

48. As to the absence of evidence of lettings either at a modern ground rent or a "market" rent, the LVT was not being asked to consider evidence of value, but only to provide assistance to the parties in preparing a valuation. The LVT was very experienced and would have been very well aware of the levels of ground rents calculated employing the conventional section 15 approach, because it would regularly have seen such rents as components of the calculation of the price payable for the freehold of premises under section 9(1) of the 1967 Act. The LVT was saying no more than that rents calculated on that conventional basis were higher than rents which would be agreed in the open market, for the reasons it gave in paragraph 63(e). Mr Loveday did not quarrel with that proposition, but said that it was irrelevant, and that a conventional section 15 approach to valuation should be adopted regardless. I disagree.

49. In my judgment the LVT was quite right to emphasise that the rental value which was to be ascertained on each review date was to be a rent which would be agreed in the open market. Its use of the expression "a marketable rent" as a way of explaining "open market letting value" (a well understood term) may not have been particularly helpful, but it is clear enough what it meant and that it intended the two expressions to be synonymous. Clause 1(b) refers specifically to the new rent being a sum representing the open market letting value of the land, to be assessed in accordance with current open market values of the Site. Any valuation technique employed to ascertain that value must be directed towards identifying the rent which would be agreed in the open market on a letting which must be assumed to take place. Any technique yielding a result which, viewed objectively, simply would not be agreed in the open market is either a flawed technique, or is being wrongly employed.

50. All of the considerations mentioned by the LVT in paragraph 63(e) and (f) are matters which would be likely to influence the level of rent which would be agreed for a development site which was offered for letting in the open market without a premium. Apart from the fact that it makes the valuation exercise theoretical and therefore very difficult, it does not matter that such a transaction would never be encountered in the open market – the parties have agreed that the assessment of the rent is to be undertaken on that basis and it is therefore necessary to assume a letting would be achieved. The LVT was well aware of that and at the start of paragraph 63 it prefaced its whole discussion of the rent review hypothesis by reminding itself that such a market did not exist and that there was no evidence of transactions on the terms which had to be assumed. Nonetheless, as the Court of Appeal had explained in *Dennis & Robinson Ltd v Kiossos Establishment* [1987] 1 EGLR 133, it must be assumed that there will be a letting of the property between a willing landlord and a willing tenant.

51. The one aspect of paragraph 63 which I initially found troubling was the possibility that by focussing on the circumstances of a tenant considering what rent to pay for the site it directed too much attention to the factors likely to restrict that rent and failed to acknowledge the existence of factors which would influence the other party to the hypothetical negotiation – the landlord - who would, of course, be seeking the highest rent which could sensibly be achieved. On reflection, however, I am satisfied that my concerns are not justified.

52. I note in particular that the LVT focussed specific attention on the current open market value of the land in paragraph 63(c), and that is what the landlord brings to the negotiation. The letting value which has to be assessed is therefore a letting value for a parcel of land of a certain capital value which must be adequately reflected in the return to the landlord.

53. Secondly, paragraph 63(e) and (f) of the decision must be understood as a response to the argument which was being presented by the Appellant, which urged the adoption of the same approach as is conventionally adopted in section 15 valuations. It is a valid criticism of such valuations that they are formulaic and place little if any emphasis on factors which would influence a rent agreed in the open market (for the very reason that evidence of such rents is not available). But it cannot be suggested that a conventional section 15 valuation ignores the perspective of the landlord since, whichever method is used to determine the capital value of the site, the second stage is always to consider what rate of income return the freeholder might expect if he were to grant a 50-year lease of the site on the terms set out in the 1967 Act (Hague: paragraph 8-06). The factors which the LVT identified in paragraph 63(e) and (f) were counterweights to the approach normally adopted under section 15, but the LVT did not suggest that the expectations of the hypothetical landlord should be left out of consideration.

54. Since the hypothetical parties are to be assumed to have reached agreement, the rent to be determined under clause 1(b) has to represent not only the highest ground rent at which a lessee would be willing to take the land, but also the lowest ground rent at which a freehold owner of the site would be willing to part with it for the duration of the hypothetical lease. If there is a gap between those figures the valuer must consider at what point that gap would be bridged in a successful negotiation between willing parties, since bridged it must be assumed to have been. I am satisfied that taking the LVT's exposition as a whole it is not inconsistent with that approach.

55. The two short points Mr Loveday took (see paragraph 44 above) concerned the marketability of a lease of a house, let on terms which include a rent review clause in the form required by section 15, or in the form of clause 1(b) of the lease. Sales of such leases cast no light on the rents which would be agreed in the open market on a letting of a bare development site for a term of years, which is the hypothesis required by clause 1(b).

56. It is hard to see why a rental valuation taking into account all of the factors identified by the LVT and a valuation for the purpose of section 15 of the 1967 Act should not arrive at the same rent, assuming the same lease length in each case and no complications over the permissible use of the site. In both cases the property to be valued is a cleared site to be let for development with rent reviews at 25 year intervals. That the results yielded by the two approaches in this case were so different (£650 a year for the first and £4,500 to £5,000 a year for the second) was a consequence of the parties' agreement based on the evidence available to them and the conclusions they drew from it. It may be that a greater degree of convergence might be expected in other cases.

57. I should add finally that Mr Loveday made it very clear that the Appellant was not to be taken to accept that the method of valuation adopted by Mr Evans in this case was necessarily appropriate for other cases. The Appellant's portfolio includes a number of leases with rent review clauses similar to that with which this appeal is concerned and Mr Loveday was anxious to avoid the impression that the same result would be agreed in other cases. Although the ground rent which the parties agreed was based on the evidence of the Appellant's valuer, it is free to argue in other cases that a "market" ground rent should be very much higher than the sum of £650 a year Mr Evans had been prepared to speak to. Since the evidence on which Mr Evans based his conclusion was a proposed sale of a long lease of a completed flat at a premium of almost £200,000 whereas the rent review clause assumes a letting without a premium, albeit of a clear site, it is perhaps understandable that the Appellant may wish to present its case less conservatively on another occasion.

58. For these reasons I reject the Appellant's second and third grounds of appeal.

Ground 4: The presumption of reality

59. The LVT had relied in paragraph 63(b) of its decision on the "presumption of reality" in support of its direction that the reviewed rent should take into account "that the letting is at a premium of £600 and that there are to be rent reviews after 25, 50 and 75 years". That presumption, which is often adopted as an aid to the interpretation of rent review clauses whose meaning is in doubt, is based on the proposition that the underlying purpose of a rent review clause is to keep the rent in line with current property values and changes in the value of money. The parties are therefore taken to have intended that the actual tenant

should pay, and the actual landlord should receive, a rent appropriate to the rights which will be enjoyed for the remainder of the term, and not a rent inflated or depressed by factors, whether beneficial or disadvantageous, which will not apply in reality. In cases of doubt the parties' assumed purpose will be respected if the assessment of the new rent is undertaken on the assumption that it is to be a rent for a letting on same terms (other than as to the quantum of rent) "as the terms still subsisting between the parties under the actual existing lease" (*per* Nicholls LJ in *Basingstoke Dean Borough Council v The Host Group* [1988] 1WLR 348, 354A).

60. Mr Loveday did not press his objection to the LVT's direction to assume a premium of £600 because he accepted that it could not be shown to have made any difference to the price which the parties had agreed should be payable for the freehold of the Property on the "market" ground rent assumption. At the preliminary issue hearing the evidence given to the LVT by Mr Evans, the Appellant's valuer, was that the ground rent would be the same whether a premium of £600 was assumed or not. That was also the basis on which he prepared his "market" ground rent valuation, which the parties were subsequently able to agree.

61. Mr Loveday's concession on the significance of his first ground of appeal seems to me to be realistic. Nonetheless, as this issue may arise in other cases, I will consider it briefly. Whatever practical effect the assumption of a very small premium may have had on the determination of the reviewed rent there is much force in Mr Loveday's original complaint that the LVT's direction in paragraph 63(b) was wrong. Mr Denyer-Green was inclined to agree that the terms of the lease did not require an assumption that the reviewed rent should be determined on the basis that a premium of £600 was to be paid for the new lease.

62. I am satisfied that the assumption of a £600 premium is not justified by the "presumption of reality". Although a premium of £600 was paid on the grant of the Lease in 1991 no further premium will become payable on the first review date in 2015 or on subsequent review dates; the assumption, not required by the express terms of the Lease, that such a premium would be paid by the hypothetical tenant taking a new lease for a term of 99 years from the review date, does not therefore reflect the reality of the terms still subsisting between the parties.

63. The underlying explanation for the presumption of reality (that the commercial purpose of a rent review clause is to compensate the landlord for changes in the value of property and in the value of money since the grant of the lease) is also difficult to reconcile with the circumstances in which this lease was granted. The original landlord, Burford, was under no compulsion to grant a new long lease, let alone one on favourable terms, yet it did so at a nominal premium and (initially) at a nominal ground rent. As the LVT put it in paragraph 59 of its decision, it is likely that both parties understood that "Burford required a pay-back at some point". The rent review was part of that pay-back, and it would be unwise to approach the rent review clause in the expectation that difficulties in its interpretation or application can be resolved by praying in aid the conventional presumption of reality

64. The context and language of other ground rent review clauses may require a different approach, and in some cases it may be appropriate to assume that the payment of a substantial premium is a term of the hypothetical new letting. The Tribunal's very recent decision in *Plotnek v Govan* [2014] UKUT 0322 (LC) is an example of such a case. In this case, however, as both parties now agree, the only assumption

that could be made was that the hypothetical lease to be granted from the review date would be on the same terms as the existing lease so far as they are applicable to a lease of a vacant site without any buildings and without the payment of a premium. Notwithstanding that the parties agreed the LVT had been wrong in relation to this issue, they were equally agreed that the point had made no difference in practical terms and that it would be inappropriate for the appeal to be allowed on that ground alone.

Conclusion

65. For the reasons I have given I dismiss the appeal. The Respondents are entitled to acquire the freehold interest in the Property for the agreed price of £10,530.

Martin Rodger QC
Deputy President

14 October 2014