LRA/120/2006

LANDS TRIBUNAL ACT 1949

LEASEHOLD ENFRANCHISEMENT – collective enfranchisement – price – valuation date – deferment rate – porter's flat – whether saleable and whether notional rent to be included in service charge – price determined at £2,835,255

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

BETWEEN **HILDRON FINANCE LIMITED** **Appellant**

and

GREENHILL HAMPSTEAD LIMITED **Respondent**

Re: 1-138 Greenhill
Prince Arthur Road
London NW3 5TY

Before: His Honour Judge Reid QC and Mr N J Rose FRICS

Sitting at Procession House, 110 New Bridge Street, London EC4V 6JL
on 12 and 13 November 2007

Kenneth Munro, instructed by Pemberton Greenish, solicitors, for the appellant
Paul Letman, instructed by Coleman Coyle LLP, solicitors, for the respondent.

The following cases are referred to in this decision:

Earl Cadogan and Cadogan Estates Ltd v Sportelli and Others [2006] RVR 382
Earl Cadogan and Cadogan Estates Ltd v Sportelli and Others [2007] EWCA Civ 1042
West Hampstead Management Co Ltd v Pearl Property Ltd [2002] 3 EGLR 55
Agavil Investments Ltd v Corner and Others CA,(1975) 3 October, unreported CA
Blendcrown Ltd v Church Commissioners for England [2004] 1 EGLR 143
Gilje and Others v Charlgrove Securities Ltd [2002] 1 EGLR 41
Earl Cadogan and Another v 27/29 Sloane Gardens Ltd and Another [2006] 2 EGLR 89

DECISION

Introduction

1. This is an appeal by Hildron Finance Limited, the landlord of a block of flats known as 1 to 138 Greenhill, Prince Arthur Road, Hampstead, London, NW3 5TY, against a decision of the Leasehold Valuation Tribunal for the London Rent Assessment Panel on a collective enfranchisement under section 13 of the Leasehold Reform, Housing and Urban Development Act 1993. The LVT determined that the price payable for the freehold interest in that property by the respondent nominee purchaser, Greenhill Hampstead Freehold Limited, should be £2,298,172. This figure was subsequently amended to £2,089,172. In both cases the price included £582,000, representing the agreed value of the intermediate landlords' interests in flats 17 and 70.

2. Permission to appeal by way of rehearing was granted by the President in respect of the following issues: valuation date, deferment rate, hope value and the value of the porter's flat. The appellant contended that, ignoring hope value, to which we refer later, the price payable should be £2,935,255 assuming the correct valuation date was 20 January 2005, the date of the landlord's counter notice, as decided by the LVT, or £2,983,521 assuming the appropriate date was 31 January 2006, the date of commencement of the LVT hearing. The respondent's expert considered that the LVT's valuation was too low, but the respondent did not ask the Tribunal to determine a figure below that fixed by the LVT.

3. Mr Kenneth Munro of counsel appeared for the appellant. He called two expert witnesses, both partners in Messrs Knight Frank of 20 Hanover Square, London W1S 1HZ, namely Mr Robert Orr-Ewing and Mr David Charles Radford. Mr Radford's evidence was confined to the valuation of the porter's flat (No.9). Counsel for the respondent, Mr Paul Letman, called one expert witness, Mr Bruce Roderick Maunder Taylor, FRICS MAE, a partner in Messrs Maunder Taylor of 1320 High Road, Whetstone, London, N20 9HP.

4. The parties did not suggest that it was necessary for us to inspect the appeal property or any of the other buildings referred to and we did not do so.

Facts

5. From the evidence we find the following facts. The appeal property lies at the northern end of the Fitzjohn/Netherhall Conservation Area. Part of the block fronts Greenhill and part fronts Prince Arthur Road. The Greenhill elevation overlooks the main High Street, which is at a lower level and is part of a busy shopping location, a short walk from Hampstead underground station.

6. The appeal property was built in the early 1930s. It is of multi-storey construction but, because of the sloping site, parts are on three storeys and parts on five. The property is generally of solid construction, although the top floor accommodation is contained within a timber framed mansard roof, with brick-built cross walls. There are a number of entrance halls/staircase areas serving different parts of the block. Each entrance hall is served by a lift. The gross internal area of each flat varies between 547 and 1,695 sq ft and there is one studio flat of 400 sq ft. There is a small brick built porter's lodge at the north-eastern corner of the site, a number of garages, limited areas for parking on site and some common areas such as refuse store and boiler room.

Deferment rate – Mr Orr-Ewing's evidence

7. Depending upon the correct valuation date, the unexpired terms of the existing unextended leases were either 63.17 or 62.15 years. Mr Orr-Ewing considered that the deferment rate of 7% determined by the LVT was too high. In his initial report dated 29 March 2007 he placed considerable reliance on this Tribunal's decision in *Earl Cadogan and Cadogan Estates Limited v Sportelli and Others* [2006] RVR 382, published after the LVT's decision which is the subject of this appeal. He considered that *Sportelli* represented a benchmark on deferment rates to which valuers should pay serious attention and he summarised the findings of the decision which he considered particularly relevant.

8. Mr Orr-Ewing said that he had heard the evidence in *Sportelli* and had given evidence himself. He deferred to the Lands Tribunal's approach to the calculation. He also agreed with the specific rates found by the Tribunal to reach a generic deferment rate of 4.75%. As for market evidence, he had said in *Sportelli* and was still of the view that there was not sufficient evidence, nor did it point sufficiently in a single direction, for it to be adopted in preference to another approach.

9. On the question of the length of lease, Mr Orr-Ewing said that he had given evidence in *Sportelli* that in his view there was less interest from investors when the unexpired terms exceeded 50 years. He remained of that view, which was contrary to the conclusion reached by the Tribunal in *Sportelli*, but whether it affected the deferment rate depended on the view the Tribunal took regarding market evidence.

10. Mr Orr-Ewing said that location was not a factor for his client in *Sportelli*. Historically, location would have been a factor in the location of the appeal property, to mark the distinction between Hampstead and Belgravia. In *Sportelli* the combined views of all the financial experts who gave evidence was that, given a sufficient length of time, growth rates would be the same regardless of area. Mathematically, they said, that was an invariable rule. Mr Orr-Ewing was not a financial expert, but he bowed to their judgment. The only question was whether growth rates would differ over the period of these particular leases. The shortest unexpired term in this appeal was 63.17 years. That was a long enough period for any short-term distortions due to local fluctuations to work themselves out. He therefore agreed that there should be no adjustment to reflect location.

11. As for obsolescence and condition, in the absence of any building or structural survey casting doubt on the ability of the structure to last until the end of the lease terms, he saw no reason for an adjustment to the *Sportelli* deferment rates. The Lands Tribunal had based its decision on whether the condition of a building would affect the current vacant possession value. It was difficult to imagine a situation where an investor would disregard the condition of a building when considering its present capital value, but take it into account when considering the appropriate deferment rate.

12. The Tribunal had considered the distinction between flats and houses in detail. Although his client's property in *Sportelli* (59 Cadogan Square/105 Cadogan Gardens) was a relatively small block, another of the properties considered, Maybury Court, was a substantial building of five blocks totalling 68 flats. The Tribunal would in his view have been wrong not to make a distinction for the difficulties of management. But it did make such a distinction and added 0.25% to the generic rate. He agreed that managing a block of flats was more complicated than managing a house, but the burden of management was devolved through a management company and managing agents, so it did not fall directly on the investor. On balance he felt that a distinction of 0.25% between houses and flats, as determined in *Sportelli*, was appropriate and that a deferment rate of 5.0% should be adopted when valuing the appeal property.

13. Mr Orr-Ewing produced a further report dated 9 November 2007, in response to an addendum statement prepared by Mr Maunder Taylor. In it he expressed the view that the same deferment rate was appropriate for Hampstead properties in general, and the appeal property in particular, as had been determined by the Tribunal in *Sportelli* for properties which were there stated to be in the Prime Central London area (PCL). There was no clear definition of PCL, but Hampstead had been included within the PCL area as used by Messrs Savills research department, both for flats and houses. It had also been included in the prime London area as defined by Messrs Knight Frank, although not in the Knight Frank prime central London area.

14. Mr Orr-Ewing produced various statistics prepared by Lonres.com which showed that the values of flats in Hampstead had been rising over the last three years, and that in that time substantial numbers of properties in the area had sold for more than £1,000,000 and over £1,000 per square foot. These statistics suggested that Hampstead properties were prime. He also produced a chart showing that the growth in flat values in north London had been very much in line with the growth in the values of all PCL properties between 1992 and 2005.

15. Finally, Mr Orr-Ewing noted that it had been accepted in *Sportelli* that Maybury Court was part of PCL. He had seen Maybury Court and in his opinion the appeal property compared favourably with it, both in terms of location and building quality.

16. In the course of cross-examination Mr Orr-Ewing expressed the following opinions. The residential market in central London was less exposed to concerns over the availability of mortgages than properties further from the centre. The availability of mortgages had a greater effect on the value of short leases than on long leases. One would expect greater price

volatility outside a prime residential area. The demand for residential property in Hampstead was no more volatile than in St James's. Although he was not a building surveyor the appeal property appeared to be, whilst not a period building, nevertheless a solid, properly built structure in a prime, but not central area. The quality of construction of a flat or house was usually reflected in its current market value. The purchaser of a flat would usually bear in mind his likely period of ownership when deciding how much to offer and that period was probably between 5 and 20 years. The short term situation was usually the best guide to the likely position over a longer period, but with a poorly built building there would be a greater perception of risk in the longer term. The internal layout of any block of flats was likely to become out-dated over a period of time, but most buildings could be reconfigured to adapt to the new demand; the important question was whether the particular building would still be in a primarily residential area at the end of the lease and there was no reason to suppose that the appeal property would not do so. Investors would be more concerned about the long term condition of a property if it were located in a declining residential area. Management problems arose from time to time in most residential buildings and tended to be resolved; the deferment rate would only increase if there was an unusual risk of such problems recurring in the long term. The risk of unrecovered service charges was reflected in *Sportelli* by a 0.25% addition to the deferment rate for flats.

Deferment rate – Mr Maunder Taylor's evidence

17. In his first report, dated 23 March 2007, Mr Maunder Taylor expressed the view that a deferment rate of 8.0% was appropriate having regard to the rate which would be charged by banks for lending for speculative property investment. It was also appropriate by reference to the rates applicable to commercial property investments in the Hampstead area. He produced details of four mixed retail and residential investments which had sold at auction between September 2004 and June 2005, showing initial yields ranging from 4.49% to 6.20%. Investors in such properties would receive an immediate rental return plus future growth. By comparison an investor in the hypothetical valuation exercise which he was undertaking would receive growth but no income, because the capital value of the ground rental income was calculated separately. With these considerations in mind, he thought that an investor who know he would receive the benefit of growth only would require a return of 8% per annum and that the deferment rates determined in *Sportelli* were out of step with what was available for other property investments with similar characteristics.

18. Mr Maunder Taylor outlined various management risks and responsibilities which would be incurred by a purchaser of the appeal property as a result of its liability for the common parts and common services and the attendant litigation risks. He pointed out that, when the block was purchased by the appellant in March 1986, the vendor (Sunley) retained for 21 years the right to the gross premiums received for all extended leases granted following the surrender of any of the original 99 year leases, less legal and surveyor's fees incurred. Mr Maunder Taylor also referred to disputes between the appellant and its lessees resulting from the appellant's attempts to erect radio masts on the roof and to develop the roof space area, as well as the risk of litigation resulting from the inclusion in the service charge of a notional rent for the porter's flat. Finally, he said that the appellant had informed the lessees that it proposed to carry out external redecoration in 2007 at a total cost, including maintenance repairs, in the

order of £1m. Mr Maunder Taylor considered there was a risk that the lessees would claim that the budgeted figure of £149,409 (net of fees and VAT) for window repairs has arisen in part because of neglect to the paintwork for many years. There was a further risk that some lessees would claim that the costs generally were more than they should be because of the appellant's failure to redecorate since 1995.

19. In Mr Maunder Taylor's opinion the appeal property had a very different management and risk profile from the properties considered in *Sportelli*, where the management responsibilities had been separated from the freehold, and a higher deferment rate should therefore be adopted. In the course of oral evidence he quantified the appropriate differential at 0.75%.

20. Mr Maunder Taylor expressed further disagreements with the conclusions reached in *Sportelli*. He quoted paragraph 88 of the Tribunal's decision in *Sportelli*, which read as follows:

> "While we accept the view of the valuers that the deferment rate could require adjustment for location, on the evidence before us we see no justification for making any adjustment to reflect regional or local considerations either generally or in relation to the particular cases before us. The evidence of the financial experts suggests that no adjustment to the real growth rate is appropriate given the long-term basis of the deferment rate, and locational differences of a local nature are, in the absence of clear evidence suggesting otherwise, to be assumed to be properly reflected in the freehold vacant possession value."

In Mr Maunder Taylor's opinion the deferment rate should (not could) be adjusted to reflect the relative locational advantages of different properties in dissimilar locations.

21. Mr Maunder Taylor also disagreed with the real growth rate of 2.0% determined in *Sportelli*. He felt the figure was too high, because it was based on long-term data with no deduction made to reflect physical improvements to the general stock of properties over the years in question. Moreover, the Tribunal had said it had assessed the risk premium by considering the individual components of the risks of investment in long term reversions, namely volatility, illiquidity, deterioration and obsolescence. In fact, said Mr Maunder Taylor, the Tribunal had failed to take account of obsolescence in the true sense of the word. It had discussed the issue of dilapidated buildings, building quality and condition. These matters related only to the building and thus the issue of deterioration. Obsolescence was something quite different. It took into account the usefulness of the building on the one hand and its relationship to site value and development potential on the other. He sought to illustrate the difference with two extreme examples. Firstly, in a slum clearance area the buildings will have deteriorated to the point where they should have been redeveloped some time ago, but the site value was so low that no private investor could be found to carry out the redevelopment. On the other hand, the office buildings in the Broadgate development in the City of London were only about 20 or 25 years old, but their site value might now justify the erection of much taller buildings on the site. Therefore, although they were prime buildings subject to little deterioration, there was already an issue of possible obsolescence. Mr Maunder Taylor

considered that there was an insufficient allowance for obsolescence and deterioration within the 4.5% risk premium determined in *Sportelli*.

22. Mr Maunder Taylor thought that the proportion of the value of the appeal property attributable to the site was high and the value of the buildings was low because the flats did not have the design, accommodation layout, services, facilities, and the fittings and finishes which were normally expected in Hampstead flats on comparable sites. The property was in a conservation area. There would always be a requirement for any building on the site to have external and other design characteristics which fitted into the conservation area. The present external design was appropriate to the conservation area status. The building, however, was about 70 years old and would be between 130 and 135 years old at the termination of the relevant leases. In Mr Maunder Taylor's opinion the extent of deterioration and obsolescence at that stage would be significant, if not substantial and a purchaser of the reversionary investment would reflect that factor in his bid.

23. Mr Maunder Taylor considered that prime central London properties were in general less prone to obsolescence than properties such as the appeal property. On the other hand, a typical 1960s suburban block of flats would be more prone to obsolescence than the appeal property. In his opinion the physical characteristics of the appeal property justified a deferment rate higher than that appropriate for a property in PCL.

24. Mr Maunder Taylor also disagreed with the *Sportelli's* approach because, he said, it did not reflect termination risks within its 4.5% risk premium. He gave two examples of cases when landlords had had difficulty in obtaining possession when the original ground leases expired. Although it was not possible to quantify the effect of such termination risks by reference to open market evidence, Mr Maunder Taylor considered that an additional risk margin of 2% was appropriate to reflect this factor.

25. In his expert report Mr Maunder Taylor also considered the extent to which the 1993 Act had affected prices paid for ground rent investments in the real world. He expressed the view that such interests were more valuable with the Act than they had been without the Act. There were four reasons for this view. Firstly, the proceeds of sales under the Act attracted the benefit of roll-over tax relief. Secondly, the Act itself had encouraged leaseholders to seek lease extensions, resulting in investors obtaining their half share of marriage value earlier than they would have done without the Act, thereby increasing their cashflow and profitability. Thirdly, purchasers of leasehold flats were encouraged by their solicitors and mortgage lenders to seek lease extensions in circumstances where many of them would not have been encouraged to do so before the Act. Finally, the Act provided a recognised method of calculating the premium payable by the leaseholder. This added certainty to the investment and reduced the investment risk. It followed, said Mr Maunder Taylor, that a deferment rate, which was appropriate in the with-Act world, was lower than the rate, which would have been applicable in otherwise identical circumstances in the no-Act world.

26. Mr Maunder Taylor's addendum report was dated 6 November 2007, after publication of the Court of Appeal judgment in *Sportelli* [2007] EWCA Civ 1042. He now accepted that, for the purposes of the present exercise, no evidence should be relied upon which was rooted in open market evidence. He observed, as did Mr Orr-Ewing, that there was no defined geographical area with recognised boundaries comprising Prime Central London. In his view, for a property to be regarded as being within PCL it must be in central London and it must be prime. Hampstead was not in central London, it was in north-west London. Nor was the appeal property prime in the sense that properties in Cadogan Square, Eaton Square or Harley Street were prime. One of the properties considered in *Sportelli* – Maybury Court – was not prime by comparison with Cadogan Square. But it was found to be prime by the Lands Tribunal. It appeared that the Tribunal had used the word "prime" in a general sense to include properties on certain London estates but not others. In Mr Maunder Taylor's view the fact that a property was on a particular estate, and therefore owned by a particular landlord, was not relevant to the issue whether it was prime. In his view, London residential properties which were truly prime had international market appeal and, because of that, a resistance to market down-turns which non-prime properties did not have.

27. Mr Maunder Taylor also took issue in his addendum report with para 91 of the Lands Tribunal's decision in *Sportelli*, which said:

> "As with location, while we do not rule out the possible need to adjust the deferment rate to take account of such matters as obsolescence and condition, we think that it would only exceptionally be the case that such factors were not fully reflected in the vacant possession value and the risk premium. Evidence would be needed to establish that they were not fully reflected in this way. Although Mr Orr-Ewing made a deduction in respect of 59 Cadogan Square and 105 Cadogan Gardens to reflect what he said was the low risk of obsolescence, no such deduction was made by Mr Clark on behalf of the freeholders, and we can see no justification for doing so."

28. Mr Maunder Taylor did not agree that the risks of future obsolescence were necessarily reflected in the current vacant possession value. That value reflected the outlook of purchasers and their mortgagees at the valuation date. In his experience most purchasers expected to own their flats for between 5 and 20 years; most mortgagees lent for a term of 25 years but expected a sale or mortgage to redeem the loan earlier. Both purchasers and mortgagees expected the building to remain viable during that period, whilst many purchasers would expect to carry out improvements to defer the effects of gradual obsolescence. Neither purchaser nor mortgagee would consider the likely obsolescence over the whole of the next 63.5 years, particular on the assumption that there would be no improvements within that period.

29. In the course of cross-examination, Mr Maunder Taylor gave the following additional evidence. He had no knowledge of the reasons for the decisions of the great London estates to grant intermediate head leases of many of their buildings, thus separating themselves from the immediate responsibilities of management. At the valuation date a prospective purchaser would have been aware that the tenants at the appeal property might in the future choose to exercise their right to manage the block. He did not know whether the tenants had asked for the necessary building works to be delayed because they lacked sufficient funds to pay for

them immediately. He did not know how many applications for lease extensions had been made between the valuation date and March 2007, when the Sunley deed expired. He accepted that the last application for planning permission to redevelop the roof space had been made in 1991.

Deferment rate – Conclusions

30. The starting point for any consideration of the deferment rate must be the decision of this Tribunal and the judgment of the Court of Appeal in *Sportelli*. The Tribunal at para 79 concluded that the generic deferment rate should be 4.75%. On length of term its conclusion (para 85) was that the deferment rate was constant beyond 20 years; that below 20 years the rate would need to have regard to the property cycle at the time of valuation; and beyond 75 years there was no reason on the evidence to conclude that the rate would be either higher or lower. On location and on obsolescence and condition the Tribunal reached the conclusions we have reproduced in paras 20 and para 27 of this decision above. Finally, on the difference between houses and flats, the Tribunal's conclusions were as follows (para 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 subject of headleases 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."

31. The Tribunal's approach was thus to identify a generic deferment rate, which LVTs should treat as generally applicable, whilst recognising that this could be subject to variation in particular cases when this was clearly justified by the evidence. The Court of Appeal recognised the appropriateness of such guidance. At para 99 Carnwath LJ said:

> "I agree with the Tribunal that an important part of its role is to promote consistent practice in land valuation matters. It was entirely appropriate for the Tribunal to offer guidance as they have done in this case, and, unless and until the legislature intervenes, to expect leasehold valuation tribunals to follow generally that lead."

32. The decision in *Sportelli* related to properties that the Tribunal accepted as being within prime Central London. So far as properties outside this area were concerned, Carnwath LJ said:

> "The Tribunal's later comments on the significance of their guidance do not distinguish in terms between the PCL area and other parts of London or the country. However, there must in my view be an implicit distinction. 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 different areas. The deferment rate adopted by the Tribunal will no doubt be the starting point; and their 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. That will be a matter for those advising future parties, and for the tribunals, to consider as such issues arise." (para 102)

33. With that guidance in mind, the first question that arises is the extent of the PCL area. Considered geographically, there is no precise boundary line. As defined by Messrs Savills, a firm with considerable experience of producing research data on the London residential property market, PCL includes Hampstead, but it is not clear whether their use of the term is intended to cover all properties in Hampstead, or merely prime properties. Another well known residential agent, Knight Frank (in which the appellant's experts are partners) excludes Hampstead from its "prime Central London" area although it includes it in its "prime London area". Mr Orr-Ewing accepted that practical considerations sometimes influenced the decisions made by agents when choosing the precise boundaries of prime Central London. We do not think Hampstead can properly be described as being within Central London. For that reason we conclude that, for the purposes of applying the *Sportelli* guidance, the appeal property is to be taken as falling outside the PCL even though Hampstead is a prime residential area.

34. We therefore turn to consider whether, in this case which concerns a property outside the PCL, the evidence has demonstrated that a departure from the deferment rate adopted in *Sportelli* is justified. Mr Maunder Taylor suggested that the rate appropriate to the appeal property should be three percentage points higher than that adopted for the flats in *Sportelli.* He made three individual adjustments, 0.75% for exceptional management problems, 1.5% for the location and 2.0% for termination risks. These adjustments totalled 4.25%, pointing to a deferment rate of 9.25%, but Mr Maunder Taylor said that valuation was not a mathematical process and his overall judgement told him that a deferment rate of 8% was right. To the extent that he did not withdraw his criticisms of the Tribunal's approach in *Sportelli*, Mr. Maunder Taylor's evidence is clearly unsustainable in the light of the Court of Appeal's judgment.

35. Mr Maunder Taylor considered that the degree of obsolescence of the appeal property was unusually high, since it would be at least 130 years old when the existing leases expired. We do not think that age on its own can be the appropriate test; the question is whether obsolescence and condition are not fully reflected in the vacant procession value and the risk premium. To the extent that the flats are, as Mr. Maunder-Taylor suggested, deficient in design, layout, services, facilities, fittings and finishes, these factors would presumably be reflected in their present vacant possession value. In our judgment the only factor mentioned by Mr. Maunder Taylor which might have a greater effect on the value at the end of the lease than it does now is the mainly timber construction of the top floors. We have borne this consideration in mind, but we have concluded that a purchaser would not feel it to be sufficiently significant to justify an increase in the deferment rate to be applied. (We would add that, when considering the impact of obsolescence on the deferment rate, the possibility that site value might exceed existing use value does not seem to us to be relevant. In this context obsolescence is concerned with the risk that a building will decline, not that the value for another purpose will increase). As far as volatility and illiquidity are concerned, none of the evidence has led us to conclude that the position is any worse in the case of the appeal property than the more centrally located properties considered in *Sportelli*.

36. We do not consider that any adjustment to the *Sportelli* starting point should be made to reflect the possibility that difficulties might arise in obtaining possession of the appeal property when the existing leases expire. Again, we are not satisfied that the relevant circumstances here are any different from those at the flats considered in *Sportelli* – which ranged from a single flat to a block of 68.

37. We now turn to the adjustment to be made to the generic deferment rate to reflect the facts that the appeal property is a block of flats and not a house, and that the freeholder has direct responsibility for managing the building. In *Sportelli* the Tribunal concluded that it was not appropriate to differentiate between flats which were the subject of headleases and those which were managed direct by the freeholder. The Tribunal left open the possibility that there could be a case for an additional allowance where exceptional management difficulties were in prospect, but we do not think that, at the valuation date, a purchaser of the appeal property would have anticipated such difficulties occurring over the long term. The Sunley deed was due to expire shortly, it is not clear that the delay in carrying out the necessary works to the property was due to any fault on the part of the freeholder, the last planning application to develop the roof had been made in 1991 and, apart from police involvement in a dispute over the proposed radio mast on the roof, there is no clear evidence of any unusual management problems having been experienced in the past.

38. In summary, none of the evidence in this appeal has persuaded us that the deferment rate should be different from the 5% applied to the flats in *Sportelli.*

39. We should add that, in an effort to show that the long-term growth rate of flats in north London was comparable to that in the PCL, Mr Orr-Ewing produced a graph showing the movement in values in both areas over a 13 year period. We do not consider that such a short period – which coincided with a general upward movement in values – is adequate for the

purpose for which it was intended. In order to provide a reliable indication of the long term movement in residential values so as to justify a departure from the *Sportelli* starting point, we consider that a period in the region of 50 years should be looked at, and that a series of statistics with different starting dates should be considered in order to ensure that an unrepresentative period is not relied upon.

The valuation date

40. There is an issue as to the correct valuation date. Before the LVT the respondent contended for the counter-notice date, 20 January 2005, whilst the appellant contended for the date of the LVT hearing, 31 January 2006. The LVT upheld the submissions of the respondent. Cases of such a dispute are likely to be rare in the future because of the amendments to the 1993 Act by the Commonhold and Leasehold Reform Act 2002 which provide for a fixed valuation date. The point which arises in this case can only arise in the case of claims made before the 2002 Act came into force.

41. In this case the valuation date is, under paragraph l(l)(a) of Schedule 6 to the 1993 Act,

> "the date when it is determined, either by agreement or by a leasehold valuation tribunal under this Chapter, what freehold interest in the specified premises is to be acquired by the nominee purchaser, or if there are different determinations relating to different freehold interests in the specified premises, the date when determinations have been made in relation to all the freehold interests in the premises."

42. The parties are agreed that the test to be applied in such cases in deciding when it is that the "freehold interest in the specified premises … to be acquired" is determined is that propounded in *Blendcrown v Church Commissioners* [2004] 1 EGLR 143 and *West Hampstead Management v Pearl Property Ltd* [2002] 3EGLR 55. It is, on those authorities, the date when in substance the extent and quality of the freehold to be conveyed is agreed or determined so that a conveyance embodying those matters can be prepared in accordance with section 34 and schedule 7.

43. The issue turns on whether the covenants sought by the appellants in the draft TR1 attached to the section 45 counter-notice went to the extent and quality of the freehold to be conveyed. The terms of the relevant paragraph (paragraph 12) were as follows:

> "The Transferee covenants with the Transferor to observe and perform the covenants on the part of the landlord contained in the leases referred to in the Schedule of Notices of Leases to the above title and any other subsisting leases or tenancies of the Property ('the Leases') and to indemnify the Transferor against all claims demands and liability in respect of any future non-observance or non-performance thereof arising from the date hereof."

44. The difference between the parties before the LVT was as to the inclusion of the words "any other subsisting leases or tenancies of the Property" in the transfer. The LVT concluded that the disputed words should not be included in the transfer and against that conclusion there has been no appeal. The question is as to the effect of the existence of that dispute before the LVT on the valuation date.

45. The appellant contended that there was no rational basis for choosing the date of the appellant's counter-notice, unless the appellant's counter-notice agreed the freehold interest in the specified premises which is to be acquired by the nominee purchaser following the decision of the LVT as to the price to be paid. It was submitted that where the parties had not agreed, the date of determination had to be one of: (i) the date of the hearing; (ii) where the hearing takes place over a period of time, the last hearing date; or (iii) the date of the LVT's decision.

46. The following points were said to support the appellants' contention:

> 46.1 It gives a date which is consistent with the date under individual lease claims, where the date was fixed by Schedule 13, paragraph 1.
>
> 46.2 There is no logical reason why there should be different valuation dates.
>
> 46.3 The second half of the statutory definition in Schedule 6 provides for a single date which is the date of the last of multiple determinations.
>
> 46.4 The reference to "what freehold interest" and "the specified premises" indicates that the freehold is not a monolithic interest: "what" has to be given some meaning. "What" could not refer, for instance, to the quality of the title or of the title guarantee to be given for that is dealt with in detail in Schedule 7, paragraph 2(2)(a) and (b).
>
> 46.5 "What freehold interest" is the freehold interest after determination of the issues which Schedule 7 requires to be addressed ("Schedule 7 issues"), i.e. issues in respect of the Law of Property Act, 1925, s.62 and s.63 (para 2); easements etc (para 3); rights of way (para 4) and restrictive covenants (para 5).
>
> 46.6 Any other date would provide the LVT with an insuperable difficulty (and a logical impossibility) if the valuation date preceded the date when Schedule 7 issues were resolved: in those cases where Schedule 7 issues had valuation implications, the LVT would not know what it was valuing. It is no answer to try and draw the line between Schedule 7 issues which do or might have valuation implications and those that do not because the LVT would still have to determine whether there were valuation implications before deciding upon value.

47. Mr Munro submitted that until 13 October 2003 leases of less that 21 years were not registerable, but took effect as overriding interests under the Law of Property Act 1925, s.70. The Commonhold and Leasehold Reform Act 2002 had reduced the length of leases which must be registered from 21 to 7 years. Leases of less than 21 years still took effect as overriding interests under Schedule 4 of the 2002 Act. Thus the vendor of a freehold interest subject to leases needed the direct covenant sought in the draft TR1 to provide it with a remedy if the purchaser failed to observe covenants in the unregistered overriding leases, or the lessee(s)

sought to enforce those covenants, or seek damages for breach, against the vendor. This was why the issue as to whether there should be an indemnity went to the extent and quality of the freehold and the covenant of indemnity went to the heart of the freehold to be conveyed. Accordingly the effect of the dispute as to the words in paragraph 12 was that there was no agreement as to the substance and quality of the freehold interest and therefore the valuation date could not be the date of the counter-notice.

48. Mr Letman contended that whether or not the disputed words were included and even if there were any short term unregistered leases (which the respondent believed there were not), it was a "phantom point". The dispute did not go to the quality of the freehold. An indemnity of this type was not within Schedule 7 of the Act, and was therefore not a matter for the LVT. There was nothing in the counter-notice to indicate any disagreement about the quality of the interest. The appellant's counter-notice had raised no issue regarding the extent or quality of the parcels nor made any leaseback proposals. Further, reference to the draft transfer showed that no rights were proposed to be granted or retained under paragraphs 7 and 10 of the counter notice.

49. Paragraph 11 of the counter notice, he submitted, proposed that the terms of the transfer were to be "in accordance with section 34 and Schedule 7 of the Act." So, unless the terms of the transfer conformed to Schedule 7 or were otherwise agreed they could not be imposed on the respondent (as provided by section 34(9)) and hence could have no effect upon the quality of the freehold.

50. Alternatively, Mr Letman submitted, the taking of an indemnity from the nominee purchaser transferee in respect of any future breach of the landlord's covenants in any unregistered leases is not a provision which by its very nature can be said to affect the extent or quality of the freehold. It does not go to the quality of the proprietary interest. Moreover, as a matter of fact the indemnity could make no difference to the freehold because there was no evidence of any short term (unregistered) leases existing at all. He further referred to the evidence of Mr Maunder Taylor to the effect that as best as he could remember, at no point in his lengthy career had he been asked to advise about an indemnity clause in the contract in relation to a valuation whether as part of his original valuation instructions, as part of any standard valuation report form, or as a question put to him after delivering his valuation report.

51. As a further alternative, the respondent submitted that the appellant was estopped by representation from asserting that the valuation date was other than 20 January 2005. In letters dated 3 and 8 August 2005 the respondent had asked for confirmation that the date of the counter-notice be taken as the valuation date, but there was no reply from the appellant. Thereafter a hearing fixed for September 2005 was adjourned at the request of the appellant, without any indication that the valuation date remained in issue. In this context it was said that the appellant's lack of response to the August correspondence amounted to a representation that the valuation date was agreed, and the respondent relied on that representation in not opposing the adjournment of the September hearing or seeking a preliminary determination regarding the terms of the conveyance. The contents of the transfer were again raised between the parties in December 2005, but there was still no indication from the appellant that there was an issue as to the valuation date.

52. In our view the LVT was correct in the circumstances of this case to take the valuation date as the date of the appellant's counter-notice.

53. The counter-notice took no issue as to the extent of the leasehold interest. The contested words in this case could not be said to raise any issue as to the quality of the freehold, given that so far as the evidence went there were no unregistered leases in respect of which the indemnity could bite, and the point was in truth a phantom point. The question whether there were any such leases was plainly raised and if there had been any, the appellant would have been in a position to adduce evidence as to what those leases were.

54. Even if there had been any such leases, it seems to us that the requirement of an indemnity could not properly be regarded as going to the quality of the freehold interest. The indemnity would have been a personal liability undertaken by the purchaser rather than an incumbrance on the property.

55. Finally, we take the view that the appellant is in any event estopped from arguing for any valuation date other than the date of the counter-notice. As Arden LJ noted at paragraph 65 in the *West Hampstead* case manoeuvring can still occur [to seek to obtain advantage in relation to the valuation date] and it is a matter for the LVT to ensure that parties do not use it improperly, so far as it can, when the matter is brought before it. Here the appellant gave a clear impression that there was no dispute as to the valuation date and as a result lulled the respondent into not taking any steps either to oppose its application for an adjournment or to have the disputed issue decided timeously.

Hope value

56. In *Sportelli* the Lands Tribunal held that hope value should, if recoverable, be quantified separately from the deferment rate but was not recoverable at all in valuations under the 1993 Act. The appellant in this appeal wished to argue that hope value is recoverable in valuations under the 1993 Act, to adduce evidence as to the amount of that hope value and to persuade us to accept the methodology adopted in *Sportelli* that hope value is equivalent to 20% of marriage value. However, since the Lands Tribunal decision in *Sportelli* has been upheld in the Court of Appeal the appellant accepts that it cannot succeed on this point at this stage. It does, however, wish to keep the point open in case the pending petition to the House of Lords in *Sportelli* is successful and the decision of the Court of Appeal on this issue is overturned.

The porter's flat

57. The LVT determined the value to be attributed to the Porter's flat at £50,000. On this appeal counsel for the appellant submitted that the appropriate figure was £300,000. Counsel for the respondent sought to uphold the figure fixed by the LVT (on the basis that the porter's flat could not be sold off) but put forward alternative figures of £100,000 and £150,000. The parties were agreed that the appropriate value for the flat, if it could be sold on a long lease, would be £300,000.

58. The basis of the LVT's decision was that the terms of the various leases of the flats at the appeal property did not permit the charging by way of part of the service charge of any notional rent for the porter's flat. It seems to have been on the assumption that the landlord could not sell the porter's flat on a long lease but was obliged to provide on site accommodation for the porter. It appears that, although the existence of different types of long lease was referred to, only one type of lease was produced as a sample before the LVT. There were at any rate three different versions of the long leases.

59. Mr Munro attacked this decision on two fronts. Firstly, the appellant was entitled pursuant to the terms of the flat leases to charge a notional rent to the service charge account and a notional rent has been and was in fact at the time of the hearing before the LVT being charged to the service charge account. He submitted that the notional rent when capitalised justified a capital value of £300,000. Alternatively, the porter's flat had a capital value of £300,000 because there was no obligation on the part of the respondent to provide a resident porter. The flat could be sold and the sale would not affect the value of the other flats in the appeal property. Therefore, it was said, a willing vendor of the reversionary interest would require, and a willing purchaser would pay, the value of the porter's flat as part of the consideration for the reversionary interest.

60. Mr Letman submitted that a willing buyer would pay only a limited speculative value of £50,000 for the flat in view of the uncertainty of being able to dispose of it, and the inevitable challenge from lessees to the lessor claiming a notional rent in respect of the flat. The disposal of the porter's flat would, it was submitted, be contrary to the terms of the first tranche of leases, the "old leases". Further there was no provision within the leases to recover the costs of porter's accommodation off site. This issue was currently to be contested before another LVT under the Landlord and Tenant Act 1985 and would offset the value of the flat if it could be sold.

The notional rent issue

61. By clause 2(2) of the old leases the lessee covenants to pay "a proportionate part of the expenses and outgoings incurred by the Lessor in … the provision of services [in the said Building] and the other heads of expenditure as the same are set out in the Fourth Schedule hereto." The Fourth Schedule of the old leases is headed "Lessor's Expenses and Outgoings and Other Heads of Expenditure, in respect of which the Lessee is to pay a proportionate part by way of Service Charge". Paragraph 5 of that schedule is in these terms: "The cost of employing maintaining and providing accommodation in the Building for a porter or porters (including the provision of uniforms and boiler suits)".

62. The second and third tranches of leases contain a covenant by the lessee to pay "the Second Rent" which is defined as meaning "the Service Charge and the Interim Charge as defined in the Sixth Schedule hereto". By the Sixth Schedule the Service Charge is defined to mean a proportion of the "Total Expenditure" which includes "(c) an annual sum equivalent to the fair rent of any accommodation owned by the Lessors and provided by them rent free to any of the persons referred to in clause 5(5)(f)". Such persons include "caretakers porters maintenance staff gardeners cleaners…"

63. The terms of clause 5(5)(f) are as follows: " For the purpose of performing the convenants on the part of the Lessor herein contained at its discretion to employ on such terms and conditions as the Lessor shall think fit one or more caretakers porters maintenance staff gardeners cleaners or such other persons as the Lessor may from time to time in its absolute discretion consider necessary and in particular to provide accommodation either in the Building or elsewhere (free from payment of rents or rates by the occupier) and any other services considered necessary by the Lessor for them whilst in the employ of the Lessor."

64. The fourth tranche of leases includes covenants and definitions in the same terms (so far as relevant) as the second and third tranches (clause 5(5)(f) had become clause 6(5)(f) in this version).

65. In our judgment the later tranche leases contain clear provisions which entitle the Lessor to recover a notional rent for the porter's flat as part of the service charge. The clear words of the schedules entitle the Lessor to recover a notional rent in respect of accommodation provided free for the porters, whether that accommodation is in the Building or elsewhere.

66. The position in relation to the first tranche leases is less clear. The question turns on whether "the cost of … providing accommodation in the Building for a porter or porters" includes, in its particular context, the loss of income from allowing a porter to occupy the porter's flat rent free. It is clear that the words do not include a notional rent for the provision of accommodation elsewhere than in the Building.

67. There have been other cases in which a similar problem has arisen. The law seems to us to be well summarized in the head note to *Earl Cadogan and Another v 27/29 Sloane Gardens Ltd and Another*[2006] 2EGLR 89, a decision of His Honour Michael Rich QC sitting in the Lands Tribunal: "It is for the landlord to show that a reasonable tenant would perceive that the underlease obliged it to make the payment sought; such a conclusion must emerge clearly and plainly from the words used. If the words used could reasonably be read as providing for some other circumstance, the landlord will fail to discharge the onus upon it. This would not permit the rejection of the natural meaning of the words in their context on the basis of some fanciful meaning or purpose, and the context may justify a "liberal" meaning. If consideration of the clause gives rise to an ambiguity, the will be resolved against the landlord as "proferror".

68. Thus in *Agavil Investments v Corner and Others* (1975) 3 October, unreported, CA., the Court held that the words "The costs charges and expenses incurred by the Lessor in carrying out its obligations under Clause 3 of this Lease" (which required the provision of a caretaker) entitled the landlord to recover payments in respect of a notional rent for the caretaker's flat. Cairns L J said "When I come to construe this lease, on the face of it, it does seem to me that the loss to the landlords by giving up this flat for the occupation of a caretaker, and therefore being unable to let the flat to a tenant falls reasonably within the words in paragraph 1 of the Schedule 'costs or expenses incurred by them in carrying out their obligations' under Clause 3 (b) (v) of the lease." But in *Gilje and Others v Charlgrove Securities Ltd* [2002] 1 EGLR 41 the Court of Appeal held that a notional rent foregone by the landlord in respect of the flat occupied by the resident caretaker could not be recovered. It could not be described as "monies

expended" so as to be recoverable under the tenant's obligation to pay a percentage of "all monies expended by the lessor in carrying out all or any of the works and providing the services and management and administration called for under clause 5(4)" (which included providing a resident caretaker or porter). "I do not consider that a reasonable tenant or prospective tenant, reading the underlease that was proferred to him, would perceive that [the paragraph] obliged him to contribute to the notional cost to the landlord of providing the caretaker's flat" was how Laws LJ put it at para 28.

69. In the present case the obligation on the lessee under clause 2(2) is "To pay to the Lessor without any deduction a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal and insurance of the said Building and the provision of services therein and the other heads of expenditure as the same are set out in the Fourth Schedule." It is difficult properly to describe the loss of a notional rent as either an "expense" or an "outgoing" or as being a "head of expenditure". The words in paragraph 5 of the Fourth Schedule "The cost of … providing accommodation" do not alter the meaning of the governing words. There are actual costs involved in the provision of the porter's flat which are properly chargeable under this head, such as repairs and water rates, but in its context it does not seem to us that the notional rent foregone can properly be said to fall within the words of the leases. In our view a reasonable tenant or prospective tenant would not consider that clause 2 (2) of the lease obliged him to contribute to the notional cost of the landlord providing the caretaker's flat. Applying the law as summarized by His Honour Michael Rich QC in *27/29 Sloane Gardens* and by parity of reasoning with the *Gilje* case nothing is recoverable for the loss of notional rent in respect of the old leases.

70. It follows that whilst the lessor is entitled to recover notional rent in respect of the porter's flat under the second and third tranches of the lease, no notional rent is recoverable under the old leases.

Sale of the porter's flat

71. The respondent submits that disposal was obviously prohibited by the terms of the old leases. The factual matrix against which the leases were to be construed included the fact that there has always been a resident porter. He referred to clause 2(2)(e) (which excludes the porter's flat when ascertaining the total rateable value of all the flats for service charge purposes), clause 6(6) by which the lessor covenants to maintain the services of a porter or porters and paragraph 5 of the Fourth Schedule which includes the cost of "maintaining and providing accommodation in the Building for a porter or porters" among the service charge items as demonstrating that there was an obligation to provide a resident porter or porters.

72. In our view this submission fails. The obligation on the lessor is to "use its best endeavours to maintain the services of a porter or porters", not "resident porter or porters". Whilst historically there may have been a resident porter and whilst there might be provision for recovering the cost of providing accommodation in the Building for the porter, it does not follow that the lessor has to discharge its obligations by providing a resident porter. It is open

to the the lessor to discharge its obligations as to portering services by non-resident porters, and to sell the porter's flat.

Porter's flat - valuation

73. Mr Maunder Taylor, giving evidence on behalf of the respondent, described the porter's flat as one of the least attractive flats. Mr Radford for the appellant was less pessimistic about the flat. He pointed out its attractive distant views. Despite this difference in view they had agreed a value of £300,000 for the flat.

74. The appellant submitted that it was this £300,000 which should be incorporated into the valuation to take account of the flat. The figure was justified as (1) the price which could be achieved on a sale or (2) its value in rental terms: £16,380 is the notional rent currently charged for service charge purposes and Mr Radford gave evidence that another flat in the block was recently let at £15,600 a year. Whether the lessor retained the flat as a porter's flat and recovered a notional rent for it or let it in the open market, its rental value justified a figure of £300,000. In Mr Radford's view any attempt to reduce that figure because the flat was being sold as part of a larger packet would be resisted by a seller in the open market. The sale of the flat would not depress the value of the other flats.

75. Mr Maunder Taylor took a different view. In his view the willing buyer in the market place would not value the flat at its price as a stand alone investment, but as a small part of a larger investment and as such would not add £300,000 to the offer price for the value of the flat. There would be the uncertainty arising from the possibility of an attempt to challenge the right to sell and if the flat were sold there would be the difficulty that the lessor would have to find outside accommodation for a porter the cost of which could not be recovered as part of the service charge. With it would come the risks and responsibilities associated with employing a porter. Costs recoverable through the service charge under the terms of the lease were limited to the extent that they were recoverable and reasonably incurred. It was not viable to sell off the flat. In his opinion the willing buyer in the market place would see the income as both speculative, with no provision for a notional rent, and with onerous responsibilities relating to employment risks. Insofar as the income would have to be recovered as part of the service charge, there was the added problem that there was, in effect, not just one tenant from whom rent had to be recovered but a considerable number with an increased chance of default. In Mr Maunder Taylor's opinion (given that the sale of the flat was not forbidden by the terms of the leases), the willing buyer in the market place would pay ten times the certified rental income in 2004, and on this basis the porter's flat had a value of £150,000. On the basis that some but not all of the lessees could be charged for the notional rent whilst the flat was retained as a porter's flat, he would attribute £100,000 to the flat.

76. In our view the value put on the flat by the appellant is over-optimistic. The sale of the flat or its reduction into possession so as to let it would create other problems in relation to the provision of portering services. It is unlikely that any purchaser would regard the flat as a stand alone investment for which he would be prepared to pay the full open market price as if it were a one-off retail sale. In addition, were the flat retained as a porter's flat, there would be a

shortfall on the notional rent because of the terms of the old leases. As against that, the figures proposed by Mr Maunder-Taylor seem to us to be too low. Even allowing for the "bulk discount" point and the difficulty created by the terms of the old leases as to recovering the notional rent, we take the view that a purchaser would attribute a greater value than £150,000 to the flat. In our judgment the appropriate figure is one of £200,000. If we are wrong in concluding that the sale of the porter's flat is not prohibited, our opinion as to the value which a purchaser would attribute to the right to receive a notional rent under the more recent leases— amounting, we understand, to some two - thirds of the total – would be £100,000.

Conclusion

77. The experts agreed that, assuming a valuation date of 21 January 2005 and a deferment rate of 5.0%, the value of all flats except Nos. 17 and 70 and the porter's flat was £2,053,255. The appeal succeeds. We determine the price payable by the respondent for the freehold interest in the appeal property, including the agreed value of the intermediate landlords' interests in flats 17 and 70, is £2,835,255 (£2,053,255 plus £200,000 plus £582,000).

78. We would add that if, contrary to the conclusion we have reached, the correct valuation date is 31 January 2006, the experts agreed that the valuation should be increased by £48,266.

Dated 10 January 2008

His Honour Judge Reid QC

N. J. Rose FRICS