UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2010] UKUT 236 (LC)
LT Case Number: LRA/163/2008

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – house used mainly for accommodating overseas students – price – whether existing use a hostel or house in multiple occupation – prospects of obtaining planning permission for change of use to single house or flats – whether property to be valued by discounting potential residential value or by adding hope value to existing use value – deferment rate – whether Sportelli provides appropriate starting point – if so whether house or flats rate relevant, whether addition should be made to Sportelli rate and, if so, how much – where in valuation should effect of statutory tenant and cost of removing restrictive covenant appear – enfranchisement price reduced from £883,955 to £606,861

IN THE MATTER OF TWO CONSOLIDATED APPEALS AGAINST A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE LONDON RENT ASSESSMENT PANEL

BETWEEN **(1) DOLOS POLYDOROU**
(2) SOTERES POLYDOROU
(in the capacity of personal representatives of Antonios Polydorou, deceased) **Appellants**

and

MANAGEMENT NOMINEES (REVERSIONS) LIMITED **Respondent**

Re: 7 Brechin Place
London
SW7 4QB

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

Sitting at 43-45 Bedford Square, London, WC1B 3AS
on 30 June and 1 July 2010

Edwin Johnson QC, instructed by David Conway & Co, solicitors, for Appellants
Kenneth Munro, instructed by D A Greenberg, solicitors, for Respondent

The following cases are referred to in this decision:

Panayi v Secretary of State for the Environment (1985) 50 P & CR 109
Cadogan v Sportelli [2007] 1EGLR 153
Hildron Finance Ltd v Greenhill (Hampstead) Ltd [2008] 1 EGLR 179
Tophams v Sefton [1967] AC 50

DECISION

Introduction

1. These are appeals by the freeholder and the lessees against a decision by the Leasehold Valuation Tribunal for the London Rent Assessment Panel (the LVT) determining the price payable for the freehold interest in a property known as 7 Brechin Place, London, SW7 4QB (the appeal property) pursuant to section 9(1C) of the Leasehold Reform Act 1967, at £883,955.

2. On 17 November 2008 the LVT granted to the freeholder permission to appeal against the decision, limited to the issue of whether the specific deductions which the LVT determined should be made in respect of tenant's improvements, the freehold restrictive covenant contained in paragraph 2 of the Second Schedule to the transfer of the appeal property to the respondent dated 22 June 2006 (the restrictive covenant) and the statutory tenancy of room 4 on the first floor of the appeal property, should have been made as deductions at the end of the valuation exercise, or at an earlier stage in the calculation. No permission was granted, or has since been granted, to appeal against the determination by the LVT of the quantum of these discounts.

3. On 6 April 2009 two further permissions to appeal were granted by the President of this Tribunal. The President made the following observations when granting permission to appeal to the tenant:

> "1. Permission is restricted to the issues of the freehold value and the deferment rate. Since permission to appeal is also being granted to the landlord in LRA/170/2008, the two appeals will be consolidated under reference LRA/163/2008 with the tenant as appellant and the landlord as respondent.
>
> 2. The applicant's contention that the starting point for the assessment of the freehold value should be the permitted use as a hostel/HMO rather than the potential use as a house is arguable. In view of the considerable financial difference which results from the two approaches, it is appropriate for this rather unusual question to be considered by the Lands Tribunal.
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> 3. Mr Lotbiniere's evidence, called by the freeholder, was that there was a good prospect of change of use to residential. It follows that there was some risk that residential planning permission might not be forthcoming. In those circumstances the LVT may have been wrong to adopt the *Sportelli* deferment rate for houses without any consideration of risk.
>
> 4. The LVT was entitled on the evidence before it to reach the conclusions that it did on relativity and the discount for the statutory tenancy."

4. In granting permission to the freeholder, Management Nominees (Reversions) Ltd, the President made the following observations:

> "1. Permission is restricted to the issue of the freehold value only. Since permission to appeal is also being granted to the landlord in LRA/163/2008, the two appeals will be consolidated under reference LRA/163/2008 with the tenant as appellant and the landlord as respondent. [Note. The permission in LRA/163/2008 was in fact granted to the tenant, the late Mr Antonios Polydorou and the appeal is being pursued by his personal representatives].
>
> 2. The LVT based its assessment of the freehold value on the sale of 23 Brechin Place. Whether that property is a relevant comparable and, if so, what adjustments should be made to the sale price are not straightforward questions. In view of that, and in view also of the considerable difference between the respective freehold valuations and the fact that permission is being granted to the tenant on the issue of freehold value, this issue should be considered by the Lands Tribunal.
>
> 3. Section 9(1A)(f) of the Leasehold Reform Act 1967 provides that the price to be paid should be calculated on the assumption that 'the vendor was selling with and subject to the rights and burdens with and subject to which the conveyance to the tenant is to be made'. The terms of the transfer were agreed prior to the LVT hearing. They specifically included reference to the relevant restrictive covenants. In those circumstances the suggestion that these covenants should have been disregarded is unarguable.
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> 4. As stated above the hypothetical sale is subject to the rights and burdens which affected the freehold. One of the burdens was the statutory tenancy. The suggestion that the LVT should have disregarded the existence of the statutory tenant is therefore unarguable.
>
> 5. The LVT was entitled to reach the conclusion that it did on the relativity of the leasehold to the freehold value."

5. Mr Edwin Johnson QC appeared for the appellants. He called two expert witnesses, namely Mr Jeremy Edge BSc, FRICS, MRTPI, the principal of Edge Planning and Development of London N1 (planning) and Mr Michael Boyle FRICS, a director of Boyle & Co of London, SW7 (valuation).

6. Counsel for the respondent freeholder, Mr Kenneth Munro, called factual evidence from Mr G T Lever, a director of JGH Residential Limited (JGH) which occupied most of the appeal property, as underlessee, for more than 10 years prior to 22 May 2006, the valuation date. Mr Munro also called, as a factual witness, Mr F Leiva, the employee of JGH responsible for managing the appeal property. In addition, Mr Munro called expert evidence from Mr N H J de Lotbiniere MRICS, MRTPI, senior partner of the London Planning Practice of London WC2 (planning) and Mr B R Maunder Taylor FRICS, MAE, senior partner of Messrs Maunder Taylor of London, N20 (valuation).

7. Mr Boyle considered that the enfranchisement price payable should be £553,169. Mr Maunder Taylor's figure was £1,075,600.

8. On 20 July 2010, we inspected the appeal property both externally and internally and we inspected certain other properties which had been referred to in evidence externally, namely 23 Brechin Place, 11 Wetherby Gardens, 12 Wetherby Place, 54 Courtfield Gardens, 167 Old Brompton Road and 171 Old Brompton Road.

Facts

9. In the light of an agreed statement of facts, the evidence and our inspection we find the following facts. Brechin Place is situated in South Kensington in the Royal Borough of Kensington and Chelsea. The immediate area is predominantly residential in character, interspersed with commercial properties including offices, a restaurant and a private preparatory school. Brechin Place mainly comprises buildings of similar construction to that of the appeal property, which have mostly been converted into self-contained flats.

10. The appeal property is situated on the south side of Brechin Place, close to the eastern (Gloucester Road) end. It has a rear (south) frontage to Old Brompton Road. Both Old Brompton Road and Gloucester Road are bus routes. There is an underground station in Gloucester Road.

11. The appeal property was erected as a mid-terrace house in the 1880s. It is arranged on basement, raised ground and four upper floors, with London stock brick and red brick faced elevations. The fourth floor accommodation is contained within a mansard roof. There is a rear garden which has been excavated to re-profile and lower the section closest to the house. The appeal property remained in single-family occupation until some years after the Second World War. It then became letting rooms and has more recently been arranged as two self-contained flats on the lower ground floor, with the balance being in use as bed-sits and ancillary accommodation.

12. As we have said, room 4 is occupied by a statutory tenant. The rear basement flat has been retained by the appellants for family use. The front lower ground floor flat was let (as below) and was used throughout the year by Lawrence University (of America) as their administrative offices. For at least 10 years prior to the valuation date there had been an annual arrangement between JGH and Lawrence University for the whole of the property demised to JGH to be occupied by the university from early October each year until early June of the following year. During this period three groups of students would each spend one semester or term at the property and most of the rooms would be occupied as bed-sits. There were shared bath or shower rooms/wcs on the ground, first and fourth floors, a classroom/common room on the ground floor, a computer room and a music room on the second floor, and a study with kitchenette and a live-in housekeeper's room on the third floor.

13. From our inspection of the properties and from the evidence we received from Mr Leiva and also from the experts, including in particular Mr de Lotbiniere in paragraph 4.4 of his report, we find that the present layout of the upper part of the property is the same as it was in all material respects as at the valuation date and included the following features. Numerous of the rooms included more than two bed spaces (three rooms having four beds and two rooms containing three beds, such beds including several bunk beds). Each room contained a form of kitchenette including a sink and a cooking unit and a refrigerator. Mr Leiva told us that students did get the keys to their room. He also said that circumstances could arise where a student arrived at the building and was introduced into a room where other people were already in occupation. That student would thus have to share with whoever else was already in the room.

14. At the valuation date the freehold reversion of the appeal property was subject to a lease dated 19 June 1969 of which the appellants, in their capacity as personal representatives of their late father, are the registered proprietors. That lease is a for a term expiring on 25 December 2030 at a commencing rent of £30 per annum, rising on 25 December 1980, 2000 and 2020 to £60, £90 and £120 per annum respectively. The unexpired lease term at the valuation date was 24.59 years. At that date the appellants' leasehold interest was subject to the underlease to JGH of the entire property apart from the rear basement flat, the rear garden and room 4 for a term of five years from 21 August 2002, paying £63,509.20, £65,890.80, £68,361.70, £70,925.26 and £73,584.96 for each consecutive year of the term. The tenancy was excluded from the security of tenure provisions of the Landlord and Tenant Act 1954 Part II.

15. The appellants accept, for the purposes of the consolidated appeal, that the deductions which were made by the LVT in respect of improvements and the statutory tenant should not have been made by the LVT at the end of the valuation of the enfranchisement price, but should have been applied to the valuation of the freehold interest unencumbered by the existing lease, prior to deferment of the resulting freehold value and prior to the consequent calculation of marriage value. That was, in fact, the approach adopted by their valuation expert before the LVT.

16. In view of the President's observations when granting permission to appeal, it is accepted that the relativity between the freehold value and the leasehold value of the appeal property was 54% as determined by the LVT. It is also agreed that the ground rent payable under the existing lease is to be capitalised at 7.5% as determined by the LVT. The total floor area of the property at the valuation date was 5,076 sq ft, as follows:

Basement	-	1,020 sq ft
Ground floor	-	955 sq ft
First floor	-	832 sq ft
Second floor	-	785 sq ft
Third floor	-	788 sq ft
Fourth floor	-	696 sq ft
		5,076 sq ft

17. No compensation is payable under section 9A of the Leasehold Reform Act 1967.

18. The freehold reversionary interest in the appeal property is subject to a restrictive covenant and will be acquired by the appellants, on completion of the enfranchisement claim, subject to that restriction.

19. The late Mr Polydorou purchased the leasehold interest in the appeal property in 1969. The freehold reversionary interest was purchased by the respondent on 22 June 2006 at a price of £650,000. This figure had been agreed prior to an auction, for which the guide price was £500,000 to £550,000. Contracts were exchanged on 22 May 2006. On the same day the late Mr Polydorou served a notice of tenant's claim upon the then freeholder. Shortly before that date Mr Polydorou had bid £600,000 for the freehold. The freeholder was aware that the enfranchisement claim was about to be served at the point when contracts were exchanged.

Issues

20. The first issue raised at the hearing related to the extent of the appeal for which permission has been granted by the President. The appellants contended that the effect of the first sentence of paragraph 1 of their permission was that there was to be a rehearing of the evidence relating to the value of the freehold interest and the deferment rate. The respondent contended that the scope of the appeal was restricted to particular sub-issues within those two issues. On the first morning of the hearing we ruled in favour of the appellants on this issue. We will set out our reasons for that ruling shortly. The remaining issues for determination are these:

(i) The status of the appeal property for planning purposes at the valuation date and the implications of this on the prospects of obtaining planning permission for use as a residential house or flats (planning use C3).

(ii) The unimproved freehold value of the appeal property.

(iii) The rate at which the value of the freehold reversion should be deferred.

(iv) Whether the LVT was right to apply its deduction of £50,000 in respect of the restrictive covenant at the end of the valuation, as a deduction from the enfranchisement price, or whether the figure should have been deducted from the freehold value before deferment.

(v) Whether the respondent is correct to apply the deduction of £50,000 for the statutory tenancy to the freehold value only in the marriage value calculation.

Preliminary Issue: Has the scope of the permission to appeal against the LVT's determination of freehold value and deferment rate been further restricted?

21. It was the contention of Mr Munro on behalf of the respondent that the wording used by the President in granting permission to appeal, and in particular the wording in paragraph 2 of the President's grant of permission (see paragraph 3 above), had the effect of limiting the appellants in the following manner. It was argued that they were entitled to contend that the wrong starting point for the assessment of freehold value had been adopted and that a starting point for use as a hostel/HMO should have been used. However it was then argued that insofar as that argument of principle failed, then the appellants were not permitted to advance any other arguments as to quantum or as to the manner in which the LVT assessed the price to be paid having adopted Mr Maunder Taylor's approach. In other words if the argument upon the point of principle failed, then the appellants could not challenge the 20% (adopted by Mr Maunder Taylor) or the 25% (adopted in their text by the LVT) as being the appropriate percentage reduction from full residential use value. A further argument advanced by Mr Munro was that paragraph 3 of the President's grant of permission limited any argument by the appellants regarding deferment rate to an argument as to whether the *Sportelli* deferment rate for houses should be adjusted (ie to take account of the risk that planning permission would not be granted at the term date for a residential user other than a hostel or HMO) and that this argument should not extend to allowing the appellants to contend that a higher deferment rate should be applied having regard to the general status or nature of the appeal property when compared with houses.

22. After hearing argument at the commencement of the hearing before us we gave our ruling upon this point. We rejected Mr Munro's arguments and ruled that the appellants were not limited in the points which they were entitled to raise in support of their contention that the freehold value and the deferment rate had been wrongly assessed by the LVT. We accept that it is regular practice for this Tribunal, upon granting permission to appeal, to impose conditions upon the extent of that permission. However the relevant statutory provision under the Commonhold and Leasehold Reform Act 2002 Act section 175 is that, if permission is granted, the appellant has a right of appeal against the decision appealed against and such appeal will be by way of rehearing. That right is not to be cut down by anything other than clear words of limitation. In the present case it is to our mind perfectly clear that the words relied upon by the respondent as allegedly indicating a restriction upon the ambit of the appeal are in fact merely words used by the learned President in indicating the reasons why he was granting permission to appeal. They were not intended as and do not take effect as any form of restriction on the ambit of the appeal. The President made clear in the opening words of paragraph 1 what was the restriction on the appeal, namely the appeal was restricted to the issues of the freehold value and the deferment rate. The appellants are entitled to argue all points which they contend are relevant to these issues. They are not limited to advancing arguments regarding the freehold value and the deferment rate by reference only to matters expressly referred to later on in the President's grant of permission.

Issue 1: What was the planning status of the appeal property at the valuation date and what were the prospects of obtaining planning permission for change to C3 residential use?

23. The experts agreed that the existing use of the appeal property was either a house in multiple occupation (HMO) or a residential hostel. Mr Edge said that there was no absolute test to establish whether or not a property was an HMO; it was a question of fact and degree in every case. In his opinion the appeal property had the characteristic of an HMO, as it was occupied by more than one household and comprised a number of non-self-contained units with shared communal facilities such as wcs and bathrooms. In addition, all the bedrooms were independently secured with individual locks. The independent letting of room 4 to a statutory tenant also indicated that the property was an HMO. This was because it related to a non-self-contained unit, as was room 10 on the third floor which was occupied by a housekeeper.

24. Mr Edge considered that the appeal property, with the exception of the basement, was an HMO, as its principal use was a residence for independent individuals who formed more than one household. However as regards each individual room he contended that this contained a separate household and that the rooms were not dormitories. Limited educational facilities existed in the property from time to time. If not occupied as bedsits, these rooms were used as communal facilities, for example computer and common rooms. He considered that these were secondary or ancillary uses, as they only occupied a small proportion of the property. The use of the property was different from a traditional school or college use, defined as C2 (residential institution) use, where the teaching element occupied a greater proportion of the building. The case for the appeal property to be defined as an HMO in planning terms was strengthened by the flexible use of up to three study/computer rooms, which were converted to bedsitting room accommodation during the university's summer vacation, or when there were more than 16 students in occupation.

25. Mr de Lotbiniere considered that the lawful use of the appeal property was as a residential hostel, but with a self-contained flat in the basement at the rear, and a single HMO unit in room 4. All the non-residential uses including the office use in the basement and the teaching use on part of the ground floor were, in his view, ancillary to the primary use as a hostel, and had subsisted for at least 10 years.

26. Mr de Lotbiniere referred to *Panayi v Secretary of State for the Environment* (1985) 50 P & CR 109, which held that a hostel had the following characteristics: the presence of dormitories and/or communal facilities; the use for specific categories of persons, such as the homeless, students or nurses, and the provision of services and/or supervision. All these criteria were satisfied in the case of the appeal property.

27. It is clear that the distinction between hostels and HMOs is not clear-cut. It is not defined in any statute or formal planning advice and the experts agreed that it is a matter of judgment as to which category is appropriate to describe a particular building. Having considered the evidence of the two planning experts on this issue, we are inclined to the view

that the appeal property is a hostel and not an HMO. We reach this conclusion because of the fact that all but one of the relevant rooms at the appeal property contained more than one bed space with, as noted above, several of them having either three or four bed spaces partly in the form of bunk beds, which to our mind appeared to be in the nature of a small dormitory. Also there is the evidence that persons within such a room would not necessarily have come together as a group for the purpose of occupying that room, but that a newcomer could be inserted into that room. We cannot conclude that, within each of the separate rooms, the persons sleeping in that room constituted a single household. Also there is the provision of some services from the resident housekeeper, the sharing of recreational facilities in the shape of the common room and the fact that the category of persons using the property was substantially students. Insofar as it is necessary for us to reach a decision as to whether at the valuation date the lawful planning use of the upper parts of the property was as a hostel rather than as an HMO we conclude that, apart from room 4, it was a hostel. However for the reasons mentioned below we do not consider that the question of whether the planning use was as a hostel on the one hand or as an HMO on the other hand is crucial to the resolution of the present case. This is because the experts agreed that, irrespective of the correct categorisation of the existing use, the prospects at the valuation date of obtaining planning permission for a change to C3 residential use were effectively the same.

28. The relevant development plan as at the valuation date comprised the London Plan 2004, Alterations to the London Plan 2006, and the Kensington and Chelsea Unitary Development Plan 2002. In particular the UDP Policy H20 (concerning HMOs) and Policy H25 (concerning hostels) are in similar terms:

> **Policy H20**
>
> "Normally to resist proposals for the conversion into self-contained accommodation of those Houses in Multiple Occupation and individual bedsitting rooms which comply with, or are capable of reaching, the standards laid down by the Housing Acts".
>
> **Policy H25**
>
> "To resist the loss of existing residential hostels except in Earls Court Ward".

The term "residential hostel" is defined in paragraph 5.5.22 of the UDP as

> "accommodation intended primarily for medium to long term permanent residential occupancy catering for a wide range of socio-economic groups, sometimes providing an element of care and should not be confused with a 'tourist hostel' which is primarily for visitors …"

Mr de Lotbiniere, whose case was that the lawful planning use was as a hostel, accepted that the nature of the hostel use (assuming he was right and that it was a hostel) was as a residential hostel within Policy H25. Accordingly, insofar as the planning use of the relevant parts of the property was as an HMO a change of use to C3 residential use would have been contrary to policy H20 and insofar as the lawful planning use was as a residential hostel a change of use to C3 residential use would have been contrary to Policy H25.

29. It was the evidence of Mr Edge that at the valuation date the prospects of obtaining planning permission to change the use of the upper parts of the building (ie disregarding the existing residential flats in the basement) to C3 residential use were remote in town planning terms, although he qualified that by saying that such permission might be available through a planning use swap. Mr de Lotbiniere expressed the view that a case could only be made for obtaining a change of use to C3 residential use regarding the upper parts of the appeal property if one or other of the following three considerations applied:

(1) the hostel use caused long term nuisance;

(2) the hostel use ceased and evidence was produced that no other hostel user would wish to use the premises;

(3) a land use swap was provided.

30. Mr de Lotbiniere accepted that there was no evidence available at the valuation date to suggest that paragraph 1 above (nuisance) applied. As regards paragraph (2) he accepted that that might have been a possibility if the premises had been vacant (which was not the case as at the valuation date) and if it could have been demonstrated that no other residential hostel would have been interested in taking the premises. Mr de Lotbiniere did not suggest that as at the valuation date there was any significant prospect that the paragraph (2) route would be available for obtaining planning permission for a C3 residential use. He expressly accepted both in his report at paragraph 5.17 and in cross examination that the only realistic prospect of obtaining consent for C3 residential use would have been a land use swap. By land use swap he meant the provision in another building of accommodation in the form of a hostel (or an HMO if the proper planning use was an HMO) such use being secured by a section 106 agreement. In effect the existing HMO or hostel space would be replaced elsewhere in premises which were not currently in such use. The replacement premises, he accepted, would probably be required to be in that part of RBKC to the south of Notting Hill and not in the Earls Court Ward. Mr de Lotbiniere accepted that, insofar as the present planning use is an HMO, then on a land use swap it may be possible to produce a better layout and to reduce the floor space required in the alternative premises, but still provide therein the same number of compliant spaces for the same number of people. However his evidence was that, insofar as the planning use is as a residential hostel, then a diminution in the floor space provided in the swap premises would not be permitted. Accordingly he accepted that it may be less burdensome to provide swap premises for an HMO as compared to a hostel.

31. The prospects of securing C3 planning consent in the future by means of a land use swap would have been relevant to the freehold value of the appeal property at the valuation date. The extent to which the C3 potential increased the value of the property above that for its existing use would depend on the purchaser's perception of the chances of a successful swap being achieved. In Mr Edge's opinion, there would not have been a realistic possibility at the valuation date of obtaining planning permission for a change of use to C3, even on the basis of a land use swap. Mr de Lotbiniere, on the other hand, considered that there would have been a good prospect of obtaining such permission. He produced details of eight properties where he had succeeded in obtaining such planning permission at various dates between 1994 and 2008. In every case where he had been instructed to secure such a planning consent, and his advice as to the suitability of the proposed swap property had been followed, planning permission had

been granted. Once a suitable swap property had been obtained, the time taken to secure the planning permission, supported by a binding section 106 agreement, had on average been seven months.

32. We accept Mr de Lotbiniere's evidence on this issue. We are satisfied that a prospective purchaser would have taken the view that the chances of obtaining residential planning permission were good, provided an adequate swap property was available. Mr Edge accepted that Mr de Lotbiniere had more experience that he did regarding land use swaps.

33. We would add this. As noted above Mr de Lotbiniere referred to the possibility that planning permission might be granted for change from hostel to C3 use without a land use swap if the appeal property were vacant and the applicant could demonstrate that no other hostel user would have been interested in taking the premises. This would normally require an extensive marketing campaign over a period of at least a year. He was, however, aware of cases where planning permission had been granted in the absence of a full marketing campaign. However Mr de Lotbiniere accepted, as we have recorded, that as at the valuation date the only realistic prospect of consent would have been a land use swap. He confirmed this in cross examination and said that if advising a hypothetical purchaser at the valuation date he would not be suggesting the paragraph (2) route (see paragraph 29 above) bearing in mind the hostel was actually in use. He would merely advise that this route might become available in future if the property became vacant and if other persons were not interested in taking it for hostel use. His evidence was thus that at the valuation date the only realistic prospect of obtaining planning permission for a C3 use was through a land use swap. We find that there was no prospect at the valuation date of planning permission being granted for the change of the appeal property to C3 use through the paragraph (2) route, for two reasons. Firstly, the appeal property was not vacant on the valuation date and, secondly, it is clear from the evidence of Mr Lever that at that date there was in fact substantial demand for the appeal property as a residential hostel. Mr Lever, who was required to attend and give evidence by reason of a witness summons served on him by the respondent, told us that he was a director of JGH and that at all relevant times he wanted a new five year lease. At one stage he had had to take a renewal lease for only four months, not because he only wanted four months but because Mr Polydorou was unwell. He was entirely happy to take a new five year lease contracted out of the Landlord and Tenant Act 1954 Part II. He also told us that the fact that Lawrence University (who had been using the premises until 2009) made a final decision in January or February 2009 no longer to use the appeal property was not a reason causing him to want only a short term. He had found alternative takers of the space, in particular Milliken University. He told us that there is and has been a demand for student accommodation which opportunities like that presented at the appeal property enable JGH to satisfy. The property is attractive to JGH, which enables it to offer student accommodation. There was a demand for such accommodation both at the valuation date and as at today's date. He said that JGH was always looking to acquire this type of property.

34. We are further confirmed in our conclusion that there was a demand for this type of property and that Mr de Lotbiniere's paragraph (2) route to securing a C3 planning permission would have been treated by a prudent planning advisor as at the valuation date as giving no

realistic prospect of success by the following material. Paragraph 5.5.21 in the UDP (under the heading "Residential Hostels") states inter alia:

> "The number of residential hostels has also been in decline and this trend seems likely to continue. This will serve to restrict still further the accommodation available to these groups."

Also Mr Maunder Taylor produced as an exhibit a report from King Sturge dated 2009 entitled London Student Accommodation Market which includes the following on page 14:

> "As shown the numbers of students are predicted to increase in London going forward but the planning process is restricting the numbers of private schemes being granted consent. Therefore, the pressure will increase on the HMO stock. If the HMO licensing results in the stock being reduced this will put even greater pressure on available accommodation."

Furthermore, there is the passage in the Planning Officer's report dated 30 October 2001 in relation to 54/56 Cromwell Road (a document produced by Mr de Lotbiniere) in which at paragraph 4.12 it is stated that a relaxation of Policy H25 in that particular case (having regard to listed building considerations) could be accepted but it continued

> "Nevertheless, there is a growing need for further hostel accommodation in the borough, particularly accommodation for homeless persons and key workers and, therefore, every attempt should be made to retain hostel accommodation where it is possible".

The foregoing would have led a prudent planning advisor as at the valuation date to conclude that the appeal property was in active use as a hostel and was required for that use, that there was no evidence that it would become vacant and unrequired for that use and that there was substantial evidence of a shortage of hostel accommodation such that it was unlikely to become unrequired for hostel use and such that RBKC would not permit a change of use to C3 residential without the provision of a swap property.

Issue 2: Value of the freehold reversion

35. Mr Boyle approached the valuation of the freehold reversion in three stages, the first of which was to consider the value of the appeal property as an investment without hope of development. He calculated the net rental income by deducting 10% from the gross income obtained from the letting to JGH, 40% from the gross income obtained from room 4 and 40% from the estimated rental value of the rear basement flat. The resultant net income was capitalised at 6%, to produce a freehold value of £1,243,755.

36. The second stage of Mr Boyle's valuation exercise was designed to ascertain whether hope value should be added to the investment value. For this purpose he relied on the sales of three buildings in the vicinity of the appeal property which were primarily in HMO use. He adjusted the sale price of each to reflect their different characteristics as compared with the

appeal property. He arrived at the following values for what he considered to be the section of the appeal property which was in HMO use:

11 Wetherby Gardens, SW5	-	£285 per sq ft.
12 Wetherby Place, SW7	-	£330 per sq ft
54 Courtfield Gardens, SW5	-	£310 per sq ft

37. Mr Boyle noted that these adjusted rates were remarkably similar. He felt he could do no better than adopt the average rate of £308 per sq ft as the value for HMO use, but with the hope of permission being granted for change to a more valuable residential use. Since his "pure HMO value" was equivalent to £245 per sq ft overall, this evidence suggested that the difference between the two figures – £63 per sq ft – represented the value of the hope itself.

38. In respect of the basement of the appeal property he adopted a figure of £540 per sq ft as representing the value including hope. This was based on 90% of his estimated overall value of the appeal property with planning permission for C3 use, and reflected Mr Edge's opinion that the authorised use of the basement at the valuation date was as two self-contained flats. Mr Boyle thus arrived at a freehold value of £1,800,183 as an HMO with hope value for C3 use. In answer to a question from the Tribunal he said that this figure would not change if the existing use was not an HMO but a hostel.

39. Finally, Mr Boyle considered the value of the appeal property assuming it had the benefit of planning permission for conversion to self-contained flats without restriction. He based this assessment on the sales of three properties in the vicinity which had been sold for development either with planning permission or where no difficulty would reasonably be assumed in obtaining permission for use either as flats or a house. The comparable properties were 23 Brechin Place, SW7 (sold in September 2006 for £3,367,890), 167 Old Brompton Road, SW5 (sold in February 2008 for £3,400,000) and 171 Old Brompton Road, SW5 (sold in July 2006 for £2m). Mr Boyle thought that the best evidence was provided by 23 Brechin Place, as it was the closest and most similar building, but the price paid should be adjusted to reflect the difference in date and the fact that the successful bid was (to the apparent surprise of the selling agent) more than £250,000 above the next bid and also to reflect the extended completion period. The resultant rate of £600 per sq ft was bracketed by the time adjusted value of £650 per sq ft for 167 Old Brompton Road and the time and condition adjusted value of £525 per sq ft for 171 Old Brompton Road.

40. Mr Boyle observed that the three "hope value comparables", averaging £308 per sq ft, suggested that the market was discounting the value with C3 planning consent (£600 per sq ft) by approximately 50%. He therefore considered that both Mr Maunder Taylor's suggested discount of 20% and the 25% discount adopted by the LVT were inadequate.

41. Mr Boyle also considered the economics of arranging a land use swap. This was something which Mr Maunder Taylor did not do and we refer to this point further below.

42. Mr Maunder Taylor said that, in his experience, the general approach of the residential property market was "overwhelmingly" to start with the vacant possession capital value and to adjust that figure to reflect the risks and available opportunities. He therefore valued the appeal property by direct comparison with what he considered to be the most reliable market evidence, namely the sale of 23 Brechin Place. That property was in the same street as the appeal property; it was a similar style of building; the sale was agreed only three months after the valuation date and the property was sold for development which involved major physical changes. The price paid therefore reflected the unimproved value of a similar neighbouring property although, unlike the appeal property, No.23 did not have a mansard roof and was therefore smaller. Mr Maunder Taylor assumed that, contrary to the information on the sales particulars, No.23 was identical in size to the appeal property, except for the presence of the existing mansard floor in the latter. Planning permission existed for a mansard extension to No.23, but Mr Maunder Taylor considered that this was not reflected in the sale price. In cross examination he accepted that he could be criticised for making in his report no adjustment at all to reflect the fact that planning permission at No.23 existed for a mansard extension. He analysed the sale price of No.23 as showing a value of £714 per sq ft; £114 more than Mr Boyle's analysis.

43. Mr Maunder Taylor used the Savills PCL SW Houses Index to adjust the sale price for time and arrived at a value of £3.127m. He increased this figure to £3.579m, to reflect the accommodation in the mansard roof of the appeal property, which he took at a slightly lower rate per sq ft than the accommodation on the floors below. In Mr Maunder Taylor's opinion, a hypothetical purchaser of the appeal property would base his deferment calculation on a vacant possession value of £3.579m, discounted by 20%. That discount reflected, both the risk that there might still be a limitation to hostel use in December 2030, and also the hope that a change of use to C3 would have been achieved, or would be achievable by that date. He therefore considered that the reversionary value to be deferred was £2,863,000. In cross examination he said that, if the valuation of the reversion had to be based on circumstances on the valuation date, rather than on likely developments over the next 24 years, the discount would be increased from 20% to between 30% and 33%. Thus Mr Maunder Taylor's suggested deduction for risk, based on the purchase of the freehold with vacant possession on the valuation date, is between 30% and 33%. This compares with the discount of approximately 50% obtained by comparing Mr Boyle's figure for properties sold with C3 planning permission (£600 per sq ft) with his figure for properties sold as HMOs (£308 per sq ft).

44. We consider that we should draw attention to the following aspects of Mr Maunder Taylor's evidence:

(1) He has based his valuation on one comparable only, namely 23 Brechin Place, which was sold with a different planning use, namely full C3 residential use. On any basis the figure thereby obtained requires substantial adjustment downward to reflect the absence of planning permission for C3 use (50% per Mr

Boyle and 33% per Mr Maunder Taylor if the adjustment is done by looking at the situation as it existed at the valuation date).

(2) As at the valuation date there was no realistic prospect of obtaining C3 consent save through a land use swap (Mr de Lotbiniere himself confirmed this) and we refer again to the matters set out in paragraphs 31 to 33.

(3) As at the valuation date there was no information available to the hypothetical purchaser or his planning advisor to suggest that the prospects for conversion from a residential hostel into C3 residential use would become easier in the future rather than more difficult. Mr Maunder Taylor himself during the course of his cross-examination accepted that the planning position might get worse or it might get better by the term date.

(4) In view of the fact that a change of use of the appeal property to C3 therefore relied upon a land use swap it is remarkable that Mr Maunder Taylor has given no consideration to the economics of such a swap. It is the respondent's case that the freehold of the appeal property, which is not in C3 use, should be valued on a basis reflecting C3 use in circumstances where such use is only available through a land use swap. It is the respondent's own evidence (through Mr de Lotbiniere) that this will cost a substantial sum. Mr Boyle confirmed that it would cost a substantial sum and went further by producing figures, by reference to other transactions, to prove how much it would cost and to show that such a cost would substantially destroy the economics of obtaining the change of use. However upon this crucial point Mr Maunder Taylor gave no evidence in his report and during the course of his cross examination merely observed: you can lose a lot, you can lose a little or you can come out all square. In effect Mr Maunder Taylor was saying that the hypothetical purchaser would increase his bid for the freehold reversion to reflect the potential extra value from a C3 use pursuant to a land use swap without making any investigation or analysis as to the economics of such a land use swap.

(5) In his expert report Mr Maunder Taylor referred to the possibility of an investor purchasing a property with the intention of breaching planning legislation in the hope that no enforcement action would be taken by the local planning authority within the statutory time period. In the course of cross-examination, however, he agreed that this was not a feasible option.

(6) Mr Boyle has provided comparables regarding sales of similar buildings in the local area sold at around the valuation date, being buildings whose planning use was HMOs rather than C3. Mr Boyle analysed these. The prices obtained upon these sales would necessarily have included such hope value as may have existed for the prospects of a change of use of such a property from HMO (or hostel) to C3. This seems to us to be important evidence. However Mr Maunder Taylor told us that he had not looked at these comparables provided by Mr Boyle (which had been available to him for a long period) and he made no analysis of them. Mr Maunder Taylor produced no such comparables of his own (ie comparables involving sales of buildings in HMO/hostel use). He also agreed that he had nothing like the experience that Mr Boyle has in this area of

London. His justification for not producing HMO/hostel comparables was that he was putting forward a completely different basis of valuation. It can here be noted that Mr Boyle was not in any substantial way challenged in cross-examination regarding these comparables. (Having regard to a passage in Mr Munro's written closing submissions where he suggested that the time for cross-examination was guillotined we would say that a substantial period, more than two hours, was available for cross-examination of Mr Boyle but he was not cross-examined upon these comparables. This may be thought hardly surprising bearing in mind Mr Maunder Taylor's lack of consideration of these comparables and his lack of any alternative such comparables. In case it is relevant it should be recorded that although time was limited the Tribunal did not at any stage require Mr Munro to cease his cross-examination, nor did he indicate at the time any desire to cross examine upon these comparables or state that, unless given further time, he would be unable to do so).

(7) In short Mr Maunder Taylor started and finished on the basis that the price should be fixed by reference to 23 Brechin Place with a discount for risk which he put at 20% (on the basis that matters may be more beneficial at the term date) or at 33% if a figure must be found as at the valuation date. However he did this on the basis, as stated in the conclusions of his report at paragraph 5.34, that this 20% discount is:

> "… to reflect the risk that there might still be a limitation to hostel use, but also reflecting the hope that a change of use to unrestricted residential use would have been achieved by that date."

We conclude that this passage, and Mr Maunder Taylor's approach, contains an unjustifiably optimistic analysis of the planning position, being an analysis which Mr Maunder Taylor suggests the hypothetical purchaser would reach without any consideration to how much a land use swap might cost.

45. We return to the question (not considered by Mr Maunder Taylor) of the economics of arranging a swap. Mr de Lotbiniere said that, in his experience, the value of the swap property after it had been changed to HMO or hostel use was usually less than the original purchase price, which in most cases reflected full residential value. Mr Boyle illustrated the likely loss in value by reference to flats in Longridge Road, Earls Court, SW5, which contained the principal swap property offered at the first attempt to obtain C3 permission for 11 Wetherby Gardens. He also referred to a property at 120 Holland Road, W14, which was being used in the current attempt to effect a swap for 11 Wetherby Gardens. Based on his three HMO comparables averaging £308 per sq ft, this evidence suggested that a loss of more than £200 per sq ft was likely to be incurred if the notional purchaser was obliged, by a section 106 agreement, to maintain the swap property as an HMO/hostel. We accept that evidence.

46. In our judgment, the uncertainty both as to the prospects and the total cost of obtaining planning permission for C3 residential use, and the size of the adjustment necessary to reflect the different planning status of 23 Brechin Place and the appeal property – whether it be 30/33% as suggested by Mr Maunder Taylor or 50% as suggested by Mr Boyle – renders this

process of comparison unreliable. We consider that a far more accurate assessment of the value of the appeal property is to be obtained by reference to the three properties cited as comparables by Mr Boyle, which were sold either as HMOs or part HMOs. As recorded above Mr Maunder Taylor did not produce any HMO/hostel comparables of his own and Mr Boyle's comparables were not challenged. As we have said, in our view the most reliable method of valuing the appeal property as an existing hostel is by reference to the sales of other properties in the vicinity which were in HMO use. The prices paid on such sales would reflect such hope as may have existed of obtaining consent for C3 use in the future. The comparison between Mr Boyle's stage 1 and stage 2 indicates that the prices achieved in the market did indeed include a significant element of hope value. The properties relied on in stage 2 included 54 Courtfield Gardens, about which the available information was very limited. We note, however, that the omission of this comparable would make virtually no difference to the average figure of £308 calculated by Mr Boyle, which we accept as the value with hostel/HMO use.

47. As for the basement of the appeal property, which is not in HMO or hostel use, Mr Boyle valued this at 90% of the overall value of £600 per sq ft which he derived from the sale of 23 Brechin Place. We accept Mr Boyle's approach to the valuation of the basement. We do not agree, however, that the time-adjusted price of £651 per sq ft paid for 23 Brechin Place should be reduced to reflect the level of the underbid, although it should be reduced to reflect the delayed completion of the sale. We find that the overall value of the appeal property, assuming C3 planning permission and based on the sale of 23 Brechin Place, was £630 per sq ft, and the value of the basement was £567 per sq ft.

Issue 3: Deferment rate

48. Mr Boyle pointed out that, in *Cadogan v Sportelli* [2007] 1 EGLR 153 the Lands Tribunal determined deferment rates for properties in Prime Central London of 4.75% for houses and 5% for flats. He considered that the starting point for the appeal property was the latter figure. Although it was a house for the purpose of the enfranchisement legislation, it was physically more akin to a block of flats, but the considerable management issues arising out of its mode of use warranted a significantly higher deferment rate than would be applicable to flats. Moreover, the appeal property was not such a good quality investment as a block of self-contained flats or a house. This was illustrated by the fact that its value had appreciated over the past few decades at a much slower rate than would have been the case if it had remained as self-contained units or a house. In the 1950s many houses in the area were converted to form guesthouses or HMOs because of lack of demand for entire houses for single occupation. Prior to that time the buildings would have been worth more as a house than as a guesthouse. Recent sales of comparable properties showed that the restricted planning use of the appeal property had resulted in it being worth considerably less than if it were a house. This was a compelling illustration of differing growth rates and thus the justification for different deferment rates. A further reason for increasing the *Sportelli* deferment rate was that the current intensive use of the building would result in a shorter period to obsolescence than would be the case if it were a single family house or a block of flats.

49. Mr Maunder Taylor thought that there was no reason to depart from the 4.75% *Sportelli* rate in the circumstances of this case. His principal point was that, whether his approach or Mr Boyle's approach was found to be correct, their estimates of freehold value both reflected the hostel/HMO use together with its "upside chances and its downside risks". It would therefore constitute double counting to adjust the *Sportelli* deferment rate to reflect these matters.

50. The appeal property was located in a prime area. It might not be in one of the traditional prime areas of Mayfair, Belgravia, Chelsea, Kensington or Knightsbridge. The Lands Tribunal had, however, determined in *Hildron Finance Limited v Greenhill (Hampstead) Ltd* [2008] 1 EGLR 179 that Hampstead was a prime area for the purposes of applying *Sportelli*. It followed, said Mr Maunder Taylor, that the part of Kensington which included the appeal property was also a prime area.

51. The four risks of investing in reversions of more than 20 years were found in *Sportelli* to be illiquidity, volatility, deterioration and obsolescence. The freehold interest in the appeal property had been submitted to public auction and sold before the auction date. There was no evidence that the market would have seen it as being any less liquid than other properties. Furthermore, the 20% discount which he had applied to the vacant possession value adequately reflected the margin which investors would require for the property "to be saleable and mortgageable in the usual way".

52. On volatility and obsolescence Mr Maunder Taylor said:

> "7.6 The risk of volatility is, in my opinion, no more for this property than is reasonably reflected in the 20% discount which I have applied to the vacant possession freehold value. Indeed, it is further my opinion that the adjustments to the vacant possession freehold value which should be made to reflect this risk have been made.
>
> 7.7 As to deterioration and obsolescence, I accept that this is an old building. However, the comparison at 23 Brechin Place is also an old building, apparently built by the same original developer at almost exactly the same time. The evidence is that a recent purchaser of 23 Brechin Place has paid a price which reflects full refurbishment costs being necessary, and therefore reflects that age and condition which fulfils the statutory assumption of unimproved in this case. It is therefore my opinion that the risks of deterioration and obsolescence are reflected in the valuation. Having said that, I have given evidence in other cases (and it is my opinion) that purchasers of a residential property for owner occupation or for letting out have a shorter term outlook with regard to deterioration and obsolescence than do many freehold investors buying for the value of the reversion. In this case, there are 24 years to the reversion and it is my opinion that the purchaser of 23 Brechin Place (whether he bought for owner-occupation or letting) would have a similar outlook in regard to the economic life of the building as an investor of the freehold reversion.

7.8 In my opinion, I see no reason to depart from the factual precedent of the *Sportelli* 5% deferment rate in the circumstances of this particular case." (The 5% figure was included in error and was intended to be 4.75%).

53. The question for us to determine is whether a departure is justified from the *Sportelli* rate by the circumstances of the appeal property. Before dealing with that question we must decide whether the appropriate *Sportelli* rate is 4.75% or 5%.

54. In paragraph 96 of *Sportelli* the Tribunal said:

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

55. Mr Munro submitted that, on the evidence, there were no increased management obligations on the appellants. He said that JGH's increased management obligations were reflected in the difference between JGH's receipts and the rent they paid to the appellants. If JGH did not renew their lease, so that the appellants inherited their management obligations, either the user would cease and with it the management obligations, or the appellants would continue to operate and would inherit the management obligations and the profit that JGH were making, or the tenants would grant a lease or licence to another operator who would take on the management obligations. Whichever route was taken, there was no justification for adjusting the deferment rate.

56. We are unable to accept that submission. JGH are responsible for ensuring that the appeal property is maintained in repair and sub-let to a number of occupiers every year. That work is clearly management intensive. It is unlikely in the extreme that JGH would have agreed to undertake the work involved if they had not anticipated making a profit. The appellants were prepared to give JGH the opportunity to make such a profit rather than undertaking the management of the individual lettings themselves. It follows in our view that, by sub-letting most of the appeal property to JGH, the appellants demonstrated that they were well aware that the management problems referred to in paragraph 96 of *Sportelli* applied equally to the appeal property.

57. In *Sportelli* a dividing line was drawn, in the context of management, between flats and houses. We are satisfied that Mr Boyle was right to take the view that the characteristics of the appeal property compare more closely with flats than with a single house. Accordingly, the question is whether a departure is justified from the 5% rate prescribed for flats in *Sportelli*.

58. Mr Boyle suggested that there were two reasons which justified such a departure, namely prospects for growth and obsolescence. In *Sportelli* the Tribunal considered the real growth component of the deferment rate in paragraph 72 and concluded that

> "a realistic, or neutral, assumption would be 2% … with any concern on the part of the investor that this rate might not be achieved being reflected in the risk premium."

59. Mr Boyle's evidence, that the value of the appeal property had grown at a rate far below flats and houses in the vicinity in the 50 years or so since it went into multiple occupation, was not challenged. In the light of that evidence we find that an investor would be concerned that the assumption of a 2% real growth rate, which was a constituent of the 5% deferment rate for flats in *Sportelli*, might not be achieved from an investment in the appeal property and that this concern would be reflected in an increase of 0.5% in the risk premium (and the deferment rate) to 5.5%. It is true that, if planning permission is granted for change to C3 use before the appellant's lease expires, the value of the freehold reversion will increase substantially. But the prospect of such an increase is reflected in the existing value of the freehold interest, which includes a significant element of hope value. To adjust the deferment rate to reflect such a prospect would constitute double counting.

60. We should add that Mr Munro emphasised Mr Boyle's agreement that he had not considered whether lower prospects of growth would be reflected in a lower risk premium. He submitted that this was contrary to paras 72 and 73 of *Sportelli*.

61. We do not accept that submission. Paras 72 and 73 read as follows:

> "72. Two features of the real growth rate assumption, in our judgment, require particular consideration. The first is the very substantial difference over a long period that can arise from different rates. A house worth £1m now would be worth £3.437m in real terms after 50 years at a growth rate of 2.5%. At 1.5% it would be worth £2.105m. It is clear that an investor who based his assessment on a particular rate would be conscious of the consequences of this rate failing to materialise, and we can see that for this reason there may well be an interaction between the growth rate assumption and the third component of the deferment rate, the risk premium. Of course the investor would also be conscious of the additional gain that would result from the assumed rate being exceeded, but the likely type of investor in a long-term reversion producing no income would be someone looking for long-term security – Mr Cullum had pension funds particularly in mind – and it is unlikely that, for such an investor, the hope that the assumed rate might be exceeded would outweigh the fear that it might not be achieved, unless the assumption as to growth was pitched at a sufficiently conservative level. In general we see force in the evidence of Professor Lizieri in the light of the factors that he referred to, but we think a realistic, or neutral, assumption would be 2%, the one made by Mr Cullum, with any concern on the part of the investor that this rate might not be achieved being reflected in the risk premium.
>
> 73. The second feature of the assumption that has to be considered, in our judgment, is that real house prices fluctuate significantly, so that at any one time they may be substantially above or substantially below the level that would have resulted from a

> projection of past average growth rates. Thus at the present time the recent sustained strength of the market has pushed prices well above the long-term trend. To base the deferment rate on the same real growth rate when prices are above the trend as when they are below the trend would run the risk of overvaluing the reversion in the former case and undervaluing it in the latter. This was not, however, a matter to which evidence was directed. Nevertheless it seems to us likely that the optimism of a buoyant market would be likely to feed through, to some extent, to investors in the sort of long-term reversions that we are considering, and that the same would be true when the market was low and pessimistic. It could therefore be expected that this would be reflected in a reduction or increase, as the case might be, in the risk premium, which would tend to counterbalance any adjustment that might otherwise seem appropriate to the growth rate. It is a reasonable working assumption, we think, that there would be an effective counterbalancing, so that the deferment rate would not need to change according to whether prices were above or below the trend. We therefore adopt 2% as the assumed growth rate."

62. In our view the Tribunal's observations to the effect that the risk premium might be changed to counterbalance any adjustment to the growth rate clearly related to a situation where prices achieved in the market were above or below the long-term trend level. The Tribunal was not intending in *Sportelli* to establish a general principle that the deferment rate would remain constant irrespective of investor's perceptions of the prospects of future growth. In the present appeal the hypothetical purchaser's concern regarding the prospects of future growth is not based on his perception of a buoyant market at the valuation date – instead it is based on the fact that the appeal property does not have a C3 residential planning use at the valuation date and the evidence shows that the values of buildings with HMO/hostel user have grown substantially less than C3 residential units over a lengthy period.

63. We do not consider that any further adjustment should be made for obsolescence. We do not overlook Mr Johnson's argument that the notional purchaser is buying the freehold subject to the lease, but without the benefit of any repairing obligations on the part of the tenant, see Section 9(1A)(c) of the 1967 Act. However it seems to us that the notional purchaser would take the view that either the occupants under an underlease would maintain the property in satisfactory condition for their own reasons (so as to be able to generate income from the hostel use and comply with any HMO licence), in which case there is no concern regarding disrepair, or the occupants would fail to maintain the property in circumstances where this failure is symptomatic of the use no longer being economic or desired. In this latter case the hypothetical purchaser will be at least as pleased to note the possibility emerging of obtaining a C3 planning permission through Mr de Lotbiniere's paragraph (2) route as he would be displeased at the prospect of obsolescence in the building which was not being dealt with through the repairing covenant. Accordingly we do not consider any further adjustment to the deferment rate is required in respect of obsolescence.

Issue 4: whether the LVT was right to apply its deduction of £50,000 in respect of the restrictive covenant at the end of the valuation, as a deduction from the enfranchisement price, or whether the figure should have been deducted from the freehold value before deferment.

64. Before coming to the question of where in the calculation the allowance for the two discounts (ie regarding the restrictive covenant and the statutory tenancy) should be placed, it is important first to note a preliminary matter. The LVT decided that an allowance of £50,000 should be made separately in respect of each point. Permission to appeal has been granted only regarding the question of where in the calculation of the price to be payable on enfranchisement are these two allowances of £50,000 each to be placed. There is no permission to appeal granted to challenge the quantum of either of these discounts or to contend that no such discounts should be allowed at all.

65. The question of where the relevant discount falls to be placed in the calculation depends to a significant extent upon what exactly that discount is said to represent. So far as concerns the discount in respect of the restrictive covenant, the LVT found that the sum of £50,000 was the premium which might be required to discharge or modify the restrictive covenant in the event that the Day Estate sought to enforce it. Thus the £50,000 is an assessment by the LVT of how much money would be required to be paid to the Day Estate to obtain whatever discharge or modification was thought necessary (see in particular paragraphs 14 and 17 of the LVT's decision). So far as concerns the £50,000 discount in respect of the statutory tenancy, this is not a sum identified by the LVT as being a sum the payment of which will produce some identified result. Instead in relation to this the LVT stated at paragraph 36 and 37 of its decision that the value of the freehold is reduced by the presence of the statutory tenancy and must be taken into account; and the LVT determined that an appropriate adjustment was £50,000.

66. We turn now to the question of where to place the £50,000 discount in respect of the restrictive covenant. Paragraph 10 of the agreed statement of facts and issues records:

> "The freehold reversionary interest in the Property is subject to the Restrictive Covenant and will be acquired by the Appellants, on completion of this enfranchisement claim, subject to the Restrictive Covenant."

The terms of the relevant restrictive covenant are as follows:

> "Not to carry on or permit to be carried on [sic] the Property or any part thereof any trade business or profession and not to use or permit the Property or any party [sic] thereof to be used for any illegal or immoral purpose or otherwise that [sic] with regard to the Property as residential accommodation."

67. We are concerned with the assessment of the price payable for the appeal property in accordance with sections 9(1A) and 9(1C) of the Leasehold Reform Act 1967 as amended. Section 9(1A) states that the price payable for a house and premises is to be the amount which at the relevant time the house and premises, if sold in the open market by a willing seller,

might be expected to realise upon certain assumptions including the assumption that the vendor was selling for an estate in fee simple subject to the tenancy. It is true, as pointed out by Mr Johnson, that the normal way of assessing the price payable includes assessing the value of the freehold with full vacant possession at the valuation date and then deferring this value until the term date. However the statute does not require that this valuer's convention is followed. We are unable to accept that it is compulsory, when considering the question of where the discount for the restrictive covenant should be made, that we ignore the fact that the hypothetical purchaser is purchasing a freehold reversion which will be subject to the existing lease – indeed the statute requires us not to ignore this but instead to assume that the freehold was being sold for an estate in fee simple subject to the tenancy.

68. The question for us therefore in our view becomes: bearing in mind that the £50,000 discount is the assessment by the LVT (not challenged or challengeable as to amount) of the cost of discharging or modifying the restrictive covenant, is this discount a sum which the hypothetical purchaser, when deciding how much to bid for the freehold reversion, would consider would need to be spent by him as soon as he had completed his purchase, or a sum which would need to be spent at the term date when the freehold with vacant possession reverted to him?

69. The restrictive covenant did not exist prior to the transfer dated 22 June 2006 of the freehold in the appeal property from the Day Estate to the respondent. Prior to that date the Day Estate had been the immediate landlord of the lessee and the lessee was not burdened by the terms of this restrictive covenant (although the lessee was subject to a covenant restricting the user of the premises in different wording in clause 1(10) of the lease). It is not open to the Day Estate and the respondent, in a transfer deed as between the two of them in 2006, to introduce a new restrictive covenant binding upon the existing lessee insofar as such covenant purports to prevent the existing lessee (ie the appellants) doing something which previously the lessee was entitled to do under the terms of the lease. Furthermore, the Day Estate had been the immediate landlord of Mr Polydorou for many years and had never sought to object to the continuation of the use of the appeal property in the manner in which it was being used at the valuation date.

70. In our view the hypothetical purchaser, on advice, would conclude:

(1) There was no realistic prospect of the Day Estate seeking to allege that the hypothetical purchaser was in breach of the restrictive covenant by omitting to bring about the cessation of a use of the appeal property which the Day Estate itself had not objected to for many years;

(2) That even if the Day Estate did seek to enforce the restrictive covenant against the hypothetical purchaser, there was no realistic prospect that the Day Estate would establish that the hypothetical purchaser was in breach. The hypothetical purchaser would not himself be carrying on at the appeal property or any part thereof any trade, business or profession. Further, bearing in mind that all that was occurring was a continuation of a state of affairs which the Day Estate themselves had countenanced for many years, the hypothetical purchaser would

conclude that there was no realistic prospect that the Day Estate could establish that the hypothetical purchaser was permitting some user in breach of the covenant, (see for example Woodfall Law of Landlord and Tenant Vol.1 paragraph 11.199 and *Tophams v Sefton* [1967] AC 50).

71. Bearing in mind that the £50,000 discount for the restrictive covenant must be taken into consideration somewhere, we conclude that it is far more likely that the hypothetical purchaser would decide to deduct it from the value of the freehold which would revert to him at the term date (on the basis that it is at the end of the term, if ever, that the hypothetical purchaser will be troubled by the restrictive covenant) rather than from the price actually paid (which would only be appropriate if the hypothetical purchaser took the view that it would be necessary to buy out the covenant effectively immediately after purchase).

72. Accordingly, despite Mr Johnson's vigorous arguments to the contrary, we conclude that the discount for the restrictive covenant should be made from the value of the freehold (which falls to be deferred) rather than from the final figure which would otherwise be payable as the price. We have not overlooked Mr Johnson's submission that the argument based upon *Tophams v Sefton* was a new point raised by the Tribunal and that, had it been raised earlier, Mr Boyle could have given valuation evidence directed towards how the hypothetical purchaser would have reacted to the suggestion that he might have a defence to a claim by the Day Estate to enforce the restrictive covenant based upon such an argument. However the appellants have always been aware that the approach of Mr Maunder Taylor was to the broad effect that the restrictive covenant simply was not a matter which would concern the hypothetical purchaser until the term date and that the market would perceive that the Day Estate had no objection to the current or any similar use of the property. We do not see any unfairness in the respondent in effect adopting, as an additional argument as to why Mr Maunder Taylor was right upon this point, a point of law raised for consideration by the Tribunal.

73. Mr Munro, very fairly, raised the point in his closing written submissions that, insofar as the Tribunal accepts his submission that the restrictive covenant discount is to be made from the freehold value on the basis that it is of no real concern until the term date, then the following adjustment needs to be made. It is agreed that the relativity to be applied (when obtaining the value of the existing leasehold interest from the value of the freehold) is 54% and there is no appeal against that figure. However Mr Munro accepted that, insofar as the £50,000 discount is made from the value of the freehold, rather than from the ultimate price to be paid, then the relativity would need adjusting as the restrictive covenant does not affect the leasehold value. We consider he is right upon this point. Accordingly when considering the existing leasehold value we apply a relativity of 54% to the value of the freehold prior to the deduction of the £50,000 discount.

Issue 5: whether the respondent is correct to apply the deduction of £50,000 for the statutory tenancy to the freehold value only in the marriage value calculation.

74. As noted above this £50,000 discount has not been identified by the LVT as representing some specific cost – it is merely an adjustment which they considered needed to be made. Mr Maunder Taylor argued that the hypothetical purchaser would not in any way be troubled by the existence of the statutory tenancy, on the basis that he was only concerned with what was ultimately going to revert to him at the term date in 24 years time. By that date he would be entirely happy that the statutory tenancy would have come to an end and that full vacant possession would be obtained. Mr Maunder Taylor therefore said that the freehold value (which is to be deferred for 24 years) would not be affected at all by the existence of the statutory tenancy, but the value of the existing leasehold would be so affected and that it is therefore only from the existing leasehold value that the £50,000 must be deducted.

75. We are unable to accept this argument by Mr Maunder Taylor. We remind ourselves of the problem which we have to solve, namely where should an allowance of £50,000 be made in respect of the statutory tenancy (it being no part of our function to consider the quantum of this allowance). Mr Maunder Taylor's analysis involves concluding that the hypothetical purchaser would make no adjustment to his bid for the freehold reversion to take into account the existence of the statutory tenancy. We disagree and we conclude that the hypothetical purchaser would make some adjustment to the value he attached to the freehold reversion. We reach this conclusion because of the obvious substantial potential depressing value upon a property if there exists a statutory tenancy within the protection of the Rent Act 1977. Even though the term date was 24 years distant we reject the suggestion that no significant reduction would be made by the hypothetical purchaser to the amount he was prepared to bid to reflect the existence of the statutory tenancy. Once it is accepted that a reduction would be made then, having regard to the ambit of this appeal, the reduction we must apply is £50,000. We reach this view quite apart from the further potential anxiety for the hypothetical purchaser (upon which we were not addressed and upon which we therefore do not rely for our conclusion) that there might be a statutory succession (see the Rent Act 1977 Schedule 1 as amended and Woodfall Vol.3 paragraph 23.059 and following)

Result

76. We attach an Appendix, being a calculation setting out our valuation incorporating the conclusions we have reached on the various issues. It produces an enfranchisement price of £606,861. The appellant's appeal is allowed and the respondent's appeal is dismissed. We determined that the enfranchisement price payable by the appellants to the respondent is £606,861.

Dated 23 July 2010

His Honour Judge Huskinson

N J Rose FRICS

Appendix

7 **BRECHIN PLACE, LONDON, SW7 4QB**
CALCULATION OF ENFRANCHISEMENT PRICE
BY LANDS TRIBUNAL

	£	£	£
Freeholder's Interest			
Capitalised ground rents – agreed			1,069
Freeholder's loss of reversion as HMO/hostel			
GF to 4F 4,056 sq ft @ £308	1,249,248		
Basement (established residential use)			
1,020 sq ft @ £567	578,340		
Gross freehold value	1,827,588		
Less £			
Statutory tenant 50,000			
Tenant's improvements 25,000			
Restrictive covenant 50,000	125,000		
	1,702,588		
P.V. £1 deferred 24.59 yrs @ 5.5%	0.2681		456,464
Value of freeholder's interest			457,533
Marriage value calculation			
Value of tenant's proposed interest		1,702,588	
Less			
Value of freeholder's interest		457,533	
Tenant's current interest: 54% of £1,752,588		946,398	
		1,403,931	
Total marriage value £1,702,588 – £1,403,931		298,657	
50% of marriage value			149,328
Total enfranchisement price			**£606,861**