UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – houses converted to flats – price payable for freehold – whether valuation must assume a sale of freehold reversion on the valuation date – held that it must – yield to be adopted for valuation on investment basis – relativity – appeal dismissed – Leasehold Reform Act 1967 s9(1A)

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

BETWEEN **(1) JOHN RICHARD WESTMACOTT** **Appellants**
(2) ALEXANDER CRAIG-MOONEY
(3) JAMES EDWARD CHICHESTER
(IN THE CAPACITY AS TRUSTEES OF THE MEYRICK 1970 SETTLEMENT)

and

(1) JOSEPH ACKERMAN **Respondents**
(2) NAOMI ACKERMAN

Re: 59 and 61 Grove Road
Bournemouth
Dorset
BH1 3AT

Before: N J Rose FRICS

Sitting at 43-45 Bedford Square, London, WC1B 3AS
on 22-24 October 2012

Ellodie Gibbons, instructed by Lester Aldridge LLP, solicitors of Bournemouth for the Appellants
Anthony Radevsky, instructed by Wallace LLP, solicitors of London for the Respondents

The following cases are referred to in this decision:

Cadogan v Sportelli [2007] 1 EGLR 153
Arbib v Cadogan [2005] 3 EGLR 139

The following cases were also cited:

Mon Tresor v Ministry of Housing [2008] 3 EGLR 13
Nailrile v Cadogan [2009] 2 EGLR 151
Re Coolrace Ltd and others' appeals [2012] 24 EG 84
31 Cadogan Square Freehold Limited v Cadogan [2010] UKUT 321 (LC)
Cadogan Square Properties Ltd v Cadogan [2010] UKUT 427 (LC)

DECISION

Introduction

1. These are two appeals, heard together, against a decision of the Leasehold Valuation Tribunal for the Southern Rent Assessment Panel, determining the prices payable for the freehold interests in two houses known as 59 and 61 Grove Road, Bournemouth under s 9(1A) of the Leasehold Reform Act 1967 (the 1967 Act) at £466,300 and £231,400 respectively. The appellants are the freeholders, the Trustees of the Meyrick 1970 Settlement, and the respondent leaseholders are Mr Joseph Ackerman and Mrs Naomi Ackerman.

2. In reaching its decision the LVT concluded that the value of the freehold reversions in the appeal properties were £945,000 (No.59) and £445,000 (No.61). The LVT made small additions to these figures to reflect hope value. It declined to make a further addition to reflect the difference between a 999 year lease and a freehold. The President granted permission to appeal by way of rehearing, limited to the reversionary freehold value only, excluding the issues of freehold uplift and hope value. References in this decision to the value of the freehold reversion are exclusive of hope value.

3. Ms Ellodie Gibbons of counsel appeared for the appellants. She called expert evidence from Mr Nigel Still, managing director of Stephen Noble Lane Fox of Bournemouth (sale prices of individual flats), Mr David Johnson BSc (Hons), MSc, MRICS of P H Warr Plc (cost of necessary works of repair) and Mr Geoffrey Bevans FRICS, CDipAF, FEWI, a sole practitioner based in Bournemouth (valuation). Counsel for the respondents, Mr Anthony Radevsky, called expert evidence from Mr Jeremy Priestly FRICS, joint managing director of You Home Ltd of Bournemouth (value of flats in existing condition and if in the same condition as the comparables upon which Mr Still relied), Mr Richard Neale FRICS, RMaPS of Richard Neale Associates of Parkstone, Poole (cost of necessary works of repair) and Mr Michael Harrington FRICS of Rebbeck Brothers of Bournemouth (valuation).

4. The reversionary freehold values spoken to by the valuation experts were as follows:

	No.59	**No.61**
Mr Bevans	£1,550,000	£795,000
Mr Harrington	£ 945,000	£445,000

Facts

5. From the evidence and my inspection I find the following facts. The appeal properties are located on the East Cliff, which is a favoured residential area in Bournemouth within a short walk of the town centre, the cliff top and the beach. The flats along this section of cliff top, together with the

West Cliff, tend to be occupied by retired or semi-retired people and second home owners. There is a large Jewish community on the East Cliff which adds significantly to its popularity in the market.

6. No. 59 comprises a large detached Edwardian style house, built about 100 years ago and extended at later dates. It was converted to nine flats in the 1950s. The two flats on the upper ground floor (Nos. 2 and 2A) are currently combined to form one large residential unit, which is occupied by the respondents as a holiday home.

7. The construction is of brick walls, with elevations finished in a buff coloured facing brick with stone banding and traditional stone cills and lintels. There have been a number of later additions including a mansard type roof covered with slate. There is an old cast iron fire escape stairway at the eastern end of the building which provides a secondary means of access to a number of the flats.

8. The accommodation is arranged as follows:

Lower Ground Floor		**m2**	**sq ft**
Flat 1	Entrance Hall, Living Room. Kitchen. Three Bedrooms. Bathroom. Separate W.C.	119.00	1,280
Flat 1B	Entrance Conservatory. Hall. Living Room. Two Bedrooms. Kitchen. Bathroom. Separate W.C.	86.60	932
Flat 1C	Entrance Conservatory. Inner Hall. Kitchen. Living Room. Two Bedrooms. Bathroom and W.C.	63.20	680
Upper Ground Floor			
Flat 2	Hall. Living Room. Two Bedrooms. Kitchen. Bathroom and W.C. Separate WC.	84.75	912
Flat 2A	Inner Hall access from Flat 2. Living Room. Dining Room. Kitchen. Two Bedrooms. Bathroom and W.C. Passage to fire escape.	170.80	1,838
First Floor			
Flat 3	Hall. Living Room. Kitchen. Two Bedrooms. Bathroom. Separate W.C.	85.70	922
Flat 3A	Hall. Living Room. Four Bedrooms, one with en-suite Shower Room. Kitchen. Bathroom. Passage to fire escape.	180.80	1,946
Second Floor			
Flat 4	Hall. Living Room. Kitchen. Two Bedrooms. Bathroom. Separate W.C.	79.60	856
Flat 4A	Hall. Living Room. Kitchen. Three Bedrooms, one with en-suite Shower Room. Bathroom & W.C. Passage to fire escape.	120.70	1,299

9. Internally the flats have high ceilings and mostly old style windows. Some are the original metal framed casements with leaded lights and others – mainly on the seaward side – are timber sliding sashes. All the flats have central heating and there is some double glazing.

10. Under the provisions of the Transfer as determined by the LVT there is an absolute restriction on carrying out operations for additions to the buildings and the elevations.

11. No.61 comprises a detached Victorian dwellinghouse, with a later loft conversion incorporating flat roofed dormer windows to the front and rear roof slopes. It is currently arranged as three self-contained flats used for student lettings.

12. The construction is of brick walls with elevations finished mainly in a red coloured facing brick. There are some tile hung sections and the roof is pitched/hipped, covered with plain clay tiles.

13. The accommodation is arranged as follows:

Ground Floor

Entrance Hall & Lobby

Flat 1 (Floor Area: 155m2 : 1,672 sq ft)

Hall. Double Bedroom with in-built en-suite bathroom. Living Room with kitchen facilities – double doors to garden. Bedroom 2 with in-built shower room. Bathroom & W.C. Bedroom 3. Bedroom 4 (single). Bedroom 5 (single). Bedroom 6 (single). Bathroom & W.C.

First Floor

Flat 2 (Floor Area: 161m2 : 1,740 sq ft)

Landing with door and staircase from ground-floor hallway. Living Room with shower room/wc off. Bedroom 1 (single) with bathroom off. Bedroom 2 (double) with bathroom off. Bedroom 3 with shower room off. Bedroom 4 (single) with shower room off. Bedroom 5 (single) with bathroom off. Kitchen.

Second Floor

Approached by separate access stairway at side of building leading to first and second floors.

Flat 3 (Floor Area: 172 m2 : 1,870 sq ft)

First-floor Landing with Bedroom and Bathroom off. Landing. Bedroom 1 (single). Bedroom 2 (double) with shower room built in. Bedroom 3 (double) with bathroom built-in. Kitchen/Living Room. Family Bathroom.

14. There is a single central heating system for the whole building and a communal electrical installation with the bills being paid by the landlord.

15. Although both properties have been the subject of certain tenant's improvements, there was no evidence to suggest that any have had a significant valuation effect.

16. The valuation date for both appeals is 12 March 2008. At that date both leases had 21.035 years unexpired and the ground rents payable were £80 per annum (No.59) and £330 per annum (No.61).

The valuation evidence

17. Mr Bevans's approach to the valuation of the freehold reversions was as follows. A purchaser of the freehold interest would be able to choose, subject to any planning or legal restrictions, what to do with the properties when the current leases expire. The market might well include investors who wished to continue letting the flats. In this seaside location, however, Mr Bevans thought that there would be a very strong market for flats for permanent occupation or as holiday homes. His valuation therefore started with the sum of the long lease values of each of the individual flats which had been provided by Mr Still.

18. Mr Still explained that the state of repair which he had assumed when arriving at his valuations was this. The external appearance of the buildings and the site would be similar to other conversions on the West Overcliff of Bournemouth. Conversions were not immaculate, purpose built blocks of flats. Rather they were character flats in buildings of local interest, originally known as 'Bournemouth villas'. The grounds should be neatly kept with lawned areas, managed flower and shrub borders and well maintained boundary fencing. The car park areas should provide one parking space for each apartment. These spaces should be marked out and identified, but the provision of a garage was not necessary to achieve his sale figures. The entrance to the driveway should preferably be gated but this was not imperative. The exterior of the buildings should be in a condition which would pass a home buyer's survey report, so as to satisfy a mortgagee.

19. Mr Still added that he had assumed that the external fire escape to No.59 would have been removed and that all windows would have UPVC units. The brickwork, pointing and roof should all pass a home buyer's report. The interior of the entrance to the building would have been decorated within one or two years of sale and have carpeted hallways and stairwell. There would be some electric heating in the hallways from a management supply and some external security lighting.

20. The interior of the flats would pass a home buyer's report and have been decorated within two years preceding the sale date. Newly fitted carpets would have been laid in all flats. Kitchens would have fitted units with built in refrigerator, freezer, cooker, hob and extractor hood and possibly a dishwasher. There should be space and plumbing for a washer/dryer. The bathrooms should be partly tiled with medium trade range white suites and a shower over the bath. Any en suite facilities should provide a shower rather than a bath. There was no need for built in wardrobes. Flooring would be vinyl or tiled in the kitchen and bathrooms. The flats would have a modern form of independent heating – either gas fired or electric.

21. Mr Still's valuations assumed the existence of a fund to take care of general maintenance and repairs. They also assumed at least one parking space per flat, with further visitors' parking available and the use of communal gardens with direct access to East Overcliff Drive to the south.

22. The sum of Mr Still's valuations of the nine flats in No.59 was £2,140,000. For the three flats in No.61 it was £775,000.

23. Mr Still was not asked to prepare valuations of the individual flats in their actual condition on the valuation date. That exercise was carried out by Mr Bevans. From Mr Still's valuations Mr Bevans deducted the estimated costs of putting both properties into the state of repair which Mr Still had assumed. For that purpose he used the cost estimates prepared by Mr Johnson, namely £592,000 for No.59 and £133,000 for No.61. Mr Bevans thus arrived at the following reversionary values:

No.59	-	£1,550,000
No.61	-	£ 640,000

24. Mr Still said that he did not agree with Mr Harrington's valuation of No. 61 in its existing condition at £445,000. That was roughly the same figure (£420,000) at which his firm had sold a semi-detached house, 39 Manor Road, in 2008. 39 Manor Road was half the size of No. 61, in an inferior location and further from the town centre. In cross examination he accepted that he had expressed the view at the LVT that the price achieved for 39 Manor Road suggested that the value of No. 61 as a single dwelling was £581,000, from which it would be necessary to deduct the costs of re-conversion.

25. In his expert report Mr Bevans responded to the LVT's criticism that his approach was a residual valuation with many variables and thus unreliable. He said that if the term residual valuation referred to any valuation which involved subtracting one or more figures from another, he must accept that he had prepared a residual valuation. In that case the term would apply to the valuation of a single flat or house, where the valuer assessed its value in good condition and deducted an estimated figure for any redecoration that was required. Mr Bevans acknowledged that where deductions were made there would be more variables, but that did not make the valuation wrong. It was a tool to reach an end figure. Provided careful consideration was given to the deductions it was likely to produce a reliable figure.

26. Mr Bevans said that, although the current appeals related to applications under the 1967 Act, he considered it appropriate to consider the methodology used to value the freehold reversion in applications under the Leasehold Reform, Housing and Urban Development Act 1993 (the 1993 Act). There the reversionary value was taken to be the sum of the values of the individual flats in the condition in which they were required to be under the relevant legislation. No assumption was made that the flats would be actually sold or that a profit would be required. The value was the value in the hands of the acquiring party. That was the basis of valuation he had adopted in these cases. In cross examination Mr Bevans said that he had no evidence to support his opinion that a purchaser would adopt that approach.

27. Mr Bevans also prepared valuations of the reversions on the investment basis. He noted that, at an auction sale of residential investments located across the UK conducted by Messrs Allsop in February 2008, the fifteen lots in respect of which a yield was ascertainable achieved prices reflecting

an average gross yield of 5%. He also produced a schedule of sales of residential investment properties located in the Bournemouth area between May 2006 and December 2007. Seven had been sold at auction by Messrs Allsop at an average gross yield of 4.30% and five by private treaty by Messrs Goadsby, where the average gross yield was 7.66%. Mr Bevans noted that the average of the Allsop and Goadsby yields, considered overall, was 5.70%. He considered, however, that each of the properties sold was in an inferior location to the appeal properties. It would therefore not be unreasonable to conclude that a price based on the national average yield of 5% might well have been achieved if Nos. 59 and 61 had been sold at the valuation date.

28. Mr Bevans applied this 5% national average yield to the gross income to produce values of £1,535,000 for No.59 and £950,000 for No.61. The former figure was £15,000 less than his assessment of No.59 based on the sum of the individual values. The latter valuation suggested, said Mr Bevans, that the best price for No.61 might be obtained from a purchaser who wished to continue letting the building to students. Mr Bevans said that he would, however, have advised a purchaser to be cautious about how long the student letting market would continue. He felt that a prudent purchaser would reduce his offer for No.61 to £795,000, being the average of his two valuation figures (£640,000 based on flat sales and £950,000 on the investment basis).

29. In oral evidence in chief Mr Bevans said that he had seen Mr Harrington's supplemental report which had been served shortly before the hearing. Having considered its contents he now accepted that four of the seven properties in the Bournemouth area sold by Allsop should be disregarded because they had been subject to regulated tenancies, so the prices paid reflected potential vacant possession values rather than rental income. The effect of excluding these four sales was to increase the average gross yield shown by the comparables to 6.90%, which Mr Bevans reduced to 6% to reflect the superior location of the appeal properties.

30. In cross examination Mr Bevans agreed that the Goadsby sales were more comparable to the appeal properties than the remaining three Allsop sales, because none of the latter were of multi-let properties and the prices paid for properties let to single tenants – like those subject to regulated tenancies – were strongly influenced by vacant possession values. The effect of excluding all the Allsop sales was further to increase the average gross yield indicated by the comparables to 7.66%.

31. In evidence at the LVT hearing Mr Harrington said that he would expect a purchaser of the freehold reversion of No.59 to calculate the value of that interest on the investment basis, that is capitalising the passing rents plus the potential rents from flats 2 and 2A. In the absence of actual accounts he thought such a purchaser would capitalise the gross income at between 8% and 8½%. Alternatively, he would estimate the landlords' outgoings in order to arrive at the net income. In a building of this type such outgoings were likely to account for between 25% and 30% of the gross income and in Mr Harrington's opinion the net rental income would be capitalised at 6%.

32. Mr Harrington produced copies of the management accounts relating to No.59 for the year ending 31 March 2008. These showed gross rents received of £53,355. It was necessary to add to that figure the potential income from flats 2 and 2A, which he estimated would amount to £23,400 per annum and result in a total gross income of £76,755. From that figure he deducted the landlord's outgoings taken from the accounts, namely £20,161. This gave a net income of £56,694 to which he applied a yield of 6%, producing a value of £943,422, rounded up to £945,000.

33. Mr Harrington said that he had found it difficult to obtain directly comparable evidence to justify his adopted yield. That was because in the period prior to the valuation date the majority of multi-let buildings such as No.59 were sold for redevelopment rather than as continuing investments. Nevertheless he considered that the yield of 6% was "a fairly generic rate used in conducting such valuations."

34. He adopted a broadly similar approach to the valuation of No.61. In that case, however, the factual position was different because the three flats were let as student accommodation. The gross income from student lettings was much higher than from standard assured shorthold tenancies, where the tenants would normally be expected to remain in occupation for much longer. On the other hand the landlords' outgoings on student accommodation were also much higher in terms of voids, repairs, maintenance, cleaning of common parts and gardening, and the operation was more risky. Mr Harrington noted that in the year to March 2008 a substantial sum, £31,101, had been spent on maintenance compared with only £5,818 in the previous year. He considered that this large amount was a "one-off" which should be spread over a number of years. In preparing his valuation he therefore assumed that in an average year the landlords' outgoings would be around 50% of income, as they had in fact been in the year to 31 March 2007. Applying a 6% yield to an assumed average net rental income of £26,643 produced a freehold value of £445,000 for No.61.

35. At the LVT hearing Mr Bevans did not produce a valuation of the freehold reversion of either of the appeal properties on the investment basis. Mr Harrington's valuations using that method were not challenged.

36. Before me Mr Harrington produced the same valuation of No.59 as he had before the LVT and for the same reasons. He also adopted the same approach to the valuation of No.61, in respect of which he said that he had now been provided with management accounts for the years to 31 March 2005 and 2006. They showed that the average annual outgoings over the four years prior to the valuation date had been 55% of the gross income rather than the 50% he had previously assumed. He did not, however, seek to adjust his valuation – by reducing his estimate of the net rental income – to reflect this additional information.

37. Mr Harrington said that at the valuation date the residential property market had dipped from its peak in 2007. Whilst a prospective purchaser might have contemplated refurbishing the buildings with a view to selling the flats, the costs of doing so in a falling market were such as to make the

venture far too risky. He concluded that in making his bids a purchaser would take account of the existing and proven circumstances only and calculate his offers by capitalising the rental income.

38. In his rebuttal report Mr Harrington disagreed with Mr Bevans's opinion that a strong market would have existed for the flats in their existing condition at the valuation date. He added that the market would have found it hard to deal with so many flats being offered for sale at the same time, bearing in mind Mr Still's evidence that only 23 flats on the East Cliff had been sold over a period of 21 months between March 2007 and December 2008.

39. Mr Harrington thought that Mr Bevans was wrong to calculate the reversionary value by aggregating the values of all the flats when held on long leases and then simply deducting the cost of putting the flats into a state of repair and condition to achieve those prices. If an individual purchaser were buying a residential unit for occupation by himself as a home or a second home that method would be perfectly acceptable. But that was not what was being valued here. There were nine flats in No.59 and three flats in No.61. Any prospective purchaser would necessarily estimate what his other costs would be. He would also want to make a profit to compensate for the risks involved in such a venture.

40. Mr Harrington also noted that the building costs estimated by Mr Neale were very considerably higher than the figures adopted by Mr Bevans, which had been based on Mr Johnson's report. Mr Harrington referred to Mr Bevans's suggestion that the flats might not actually be disposed of and that a profit would not be required. He said that this begged the question of what the purchaser would do with nine flats in No.59 and three in No.61, particularly if he was not wanting to make a profit. He said that the purchaser would let the flats, which was precisely the basis upon which he (Mr Harrington) had carried out his valuations.

41. Mr Harrington then produced residual valuations of Nos.59 and 61 on the assumption (which he did not accept) that the costs produced by Mr Johnson and the values provided by Mr Still were correct. This exercise produced values of £961,200 (No.59) and £429,000 (No. 61), which were much the same as his valuations on the investment basis.

42. When these residual calculations were put to Mr Bevans in cross examination he agreed with them, on the assumption that the purchaser was proposing to do the necessary works immediately and then sell off the flats. He did not accept, however, that it was appropriate to value on that basis.

43. Mr Priestly said the number of flats in East Cliff which were sold declined rapidly from the third quarter of 2007 onwards, to an initial low point in the second quarter of 2008 when only 13 units were sold. The number of flats in East Cliff sold in the whole of 2008 was less than half the 165 sold in the previous year. The impact of this decline would have been very significant for the hypothetical sale of the twelve flats in the appeal properties. Those flats, if offered for sale in the second quarter of 2008, would have represented approximately half of the total market. He considered that this would have reduced the prices obtainable for the units by between 10% and 20%. Even if one had regard to the total number of flats sold in 2008 the subject flats would still have represented about 15% of the market which, in Mr Priestly's view, would have reduced values

by between 10% and 15%. Mr Priestly added that the reduction in activity in the residential property market was a direct reflection of the reduced availability of mortgage finance in the first two quarters of 2008.

44. Mr Priestly valued the properties in their existing state, incorporating a discount of 15% to reflect the bulk purchase of twelve flats and a further discount of 15% to reflect the depressed market conditions at the valuation date, at the following figures:

No. 59	£1,000,000
No. 61	£ 355,000

Valuation by reference to flat sale prices on long leases

45. In support of Mr Bevans's approach of arriving at the value of the reversion by aggregating the values of the individual flats, Ms Gibbons referred in her opening skeleton to the following extracts from the Lands Tribunal's decision in *Cadogan v Sportelli* [2007] 1 EGLR 153:

> "52. The nature of the investment being assumed may be analysed thus: the value of the asset consists of its prospect of appreciation: it will appreciate through the lapse of time as the term date gets nearer (inherent growth); if, however, the vacant possession value of the property increases in real terms, the reversion will appreciate through real growth in the same way as the property in possession…
>
> 76. The attraction of the investment would be its relative security, the prospect of growth and the opportunity for both long-term retention and earlier sale."

46. Ms Gibbons submitted that whilst, in order to arrive at a value for a reversion, it might be necessary to value the freehold with vacant possession as at the valuation date, that was not what the hypothetical purchaser was receiving at that date: he was receiving a right to that value at a future date, in this case, in 21.035 years' time. The hypothetical purchaser would therefore always be an investor, as opposed to an owner occupier. The hypothetical purchaser might seek to realise his investment in a number of ways and would calculate his bid accordingly. He might wish to hold the investment long-term and, once the leases expire, continue letting the flats on short-term lets; or sell the flats on long leases; or let some whilst selling others; or occupy one of the flats (or two, as the respondents have done) and either let or sell the remainder. Alternatively, he might wish to realise his investment by earlier sale. Such a sale could be voluntary or, in the present case, it must be assumed that it could be by virtue of a claim under the Leasehold Reform, Housing and Urban Development Act 1993 ("the 1993 Act"). Since, at the valuation date, the leases had just over 21 years unexpired, it would have been possible for the owners of the leases to grant underleases of one or more flats for terms in excess of 21 years (as the respondents did), which in turn could be extended under the 1993 Act or could lead to a claim for collective enfranchisement.

47. In view of these possible courses of action it was not inappropriate to value the freehold with vacant possession by capitalising the rental income, as Mr Harrington had done. However, if there

was greater value to be realised by selling the flats on 999 year leases, the hypothetical purchaser who calculated his bid on that basis would outbid the purchaser bidding on the basis of a capitalised rental stream. The market value would therefore be based on the aggregated near freehold values of the flats.

48. In his opening skeleton Mr Radevsky argued that Mr Bevans's approach of adding together the estimated sale prices of the individual flats on long leases, and deducting the estimated cost of works, was a flawed form of residual valuation. The cost of works was not assessed on the basis of bringing the flats up to the standard required to sell them. The valuations took no account of fees, finance costs, selling costs, or developer's profit.

49. In response to a request from me during cross examination of Mr Harrington for clarification of the appellant's submission that the valuer was not bound to assume a sale of the freehold on the valuation date with vacant possession, Ms Gibbons referred to the fact that Mr Priestly had arrived at his valuation of the appeal properties in two stages. He firstly estimated the sale price of the individual flats on the basis of values at the valuation date. He then made a discount to reflect market circumstances as at the valuation date. He had therefore distinguished between market values in March 2008 and the factors in the market at that date which would affect sales. Mr Bevans's approach was not inconsistent with any of the legal authorities which dealt with the deferment rate.

50. In closing Mr Radevsky made the following submissions. The exercise carried out by Mr Bevans, of simply aggregating the sale prices of the flats and deducting the cost of the necessary works, without reference to any of the other costs which would be incurred in achieving the assumed sale prices, was not one which would be undertaken at the valuation date by a prospective purchaser of the freehold. In support of this contention Mr Radevsky cited the decisions of the Lands Tribunal in *Sportelli* and *Arbib v Cadogan* [2005] 3 EGLR 139.

51. At para 86 of *Arbib* the Tribunal (HH Judge Michael Rich QC and P H Clarke FRICS) said:

> "The second, and more important element of the open market value of the landlord's interest, is the value of the right to vacant possession at the end of the term. This, it is accepted, can be arrived at only by assessing the market value of the relevant premises unencumbered by the tenant's lease as at the valuation date, and applying an appropriate deferment rate to reflect the postponement of that interest until the expiry of the term."

52. In *Sportelli* the Tribunal (George Bartlett QC, President, H.H. Michael Rich QC and P R Francis FRICS) said at para 2:

> "By valuers' convention, the value of the right to receive a ground rent during the term has been assessed separately from the value of vacant possession at the end of the term. The former is ascertained by capitalisation of the ground rent to arrive at the present value of the flow of income as at the valuation date. The latter has been arrived at by ascertaining the open market value of the freehold interest with vacant permission as at the valuation date and then adjusting that value to reflect the fact that vacant possession will not be available until the end of the term. The adjusting factor is called the 'deferment rate'. The valuers in the present

cases explain it thus: it is 'the annual discount applied, on a compound basis, to an anticipated future receipt (assessed at current prices) to arrive at its market value at an earlier date [that is to say the valuation date]."

53. Thus, said Mr Radevsky, contrary to Ms Gibbons's submission, the valuer was bound to value the property assuming a freehold sale with vacant possession at the valuation date, and then defer that value until the end of the lease. It was significant that the expert witness called by the appellants to give evidence on the value of the individual flats at the valuation date, Mr Still, had not been asked to value them in their actual condition at that date.

54. It was clear from *Arbib* and *Sportelli* that the correct way of valuing the reversion was to estimate the present market value and then apply a deferment rate to reflect the period until lease expiry. The valuation assumed a sale of the property at the valuation date. The deferment by 21 years was taken into account by the deferment rate. Mr Bevans had sought to reflect the disrepair of the flats by simply aggregating Mr Still's estimated sale prices in an improved condition and deducting the estimated cost of the necessary works to achieve that condition. That was plainly not an exercise that a purchaser of the freehold would have carried out at the valuation date. Such a purchaser would not pay a price which ignored the other costs of bringing the properties up to the standard which would be needed to achieve the estimated sale proceeds. He would carry out a residual valuation which took account of professional fees, purchase costs, interest on capital, sales costs and developer's profit. Mr Harrington had prepared such a calculation, which assumed in the appellants' favour that the sale price and building costs suggested by Mr Still and Mr Johnson were accurate. This exercise had produced approximately the same figures as the valuations on the investment basis for which Mr Harrington had contended before the LVT and this Tribunal.

55. Residuals were generally an unsatisfactory method of valuation because of the number of variables that they contained. In this case, however, there had been no challenge to any of the elements in Mr Harrington's residual calculations. It was therefore safe to assume that they were the sort of exercise that would be carried out by a potential purchaser. But it was wholly unrealistic to suggest that one simply deducted the cost of works without regard to any other costs which a purchaser would incur.

56. In closing Ms Gibbons cited the first paragraph of *Sportelli*, which read:

"The Leasehold Reform Acts give the holders of long leases of residential premises the right to 'enfranchise' their interests by extension of their leases or purchase of the freeholder's interest. The statutory provisions for the assessment of the price payable on such enfranchisement of the higher value houses brought within the leasehold enfranchisement provisions by section 9(1A) of the Leasehold Reform Act 1967, and of flats, whether by way of collective enfranchisement or a single extended lease, under the Leasehold Reform, Housing and Urban Development Act 1993, all require the ascertainment, upon assumptions to which we will return later, 'of the amount which at the valuation date [the freeholder's] interest might be expected to realise if sold on the open market by a willing seller.'"

57. Thus, said Ms Gibbons, the 1967 Act and the 1993 Act both assumed a sale on the valuation date. But the sale was of the freeholder's interest in reversion, because the first assumption was that the interest was sold subject to the existing lease or leases. That was recognised in *Sportelli* at para 2 (para 51 above). There was no mention in the 1967 Act of the requirement to value the freehold with vacant possession. Valuers had established a convention that the calculation should be carried out on that basis simply in order to arrive at the valuation required by statute.

58. Ms Gibbons said that, in most 1967 Act cases, the open market value was established by reference to sales of comparable properties in the market, that is sales of houses. The prices paid for such comparables would then be adjusted to allow for any differences between them and the subject property. That approach was referred to by the Lands Chamber (H H Judge Nicholas Huskinson and A J Trott FRICS) in *31 Cadogan Square Freehold Ltd v Cadogan* [2010] UKUT 321 (LC) as the 'bottom up approach', based upon the analysis of buildings configured as flats which had been purchased ready for conversion to houses (see paras 51 and 128).

59. In contrast to the position in *31 Cadogan Square* neither party had adopted such an approach (with the single exception of 39 Manor Road – see para 69 below). That was because, in contrast to most 1967 Act cases, the appeal properties were arranged as flats. Mr Bevans and Mr Harrington were agreed that, if this were an enfranchisement under the 1993 Act, one would aggregate the values of the individual flats let on long leases. When calculating the vacant possession value under the 1993 Act the property was assumed to be vacant, none of the flats being held on a long lease. The position in this case was exactly the same. Upon the expiry of the two existing leases the freeholder would be left with a vacant building, arranged as flats. Ms Gibbons said that she had never come across a freehold interest being valued on collective enfranchisement on the assumption that all flats were let on assured shorthold tenancies. The reason was that the valuer could not know what would happen when the leases expired in 21 years time – they could either be sold on long leases or let on assured shorthold tenancies.

60. Ms Gibbons accepted that the condition of the properties assumed under the 1967 Act could be different. That was because, as Mr Radevsky had explained, under the 1993 Act all flats would be let on long leases which required the landlord to keep the building in repair and recover a service charge, so the costs of repair would be borne by the lessees. Consequently, at the end of the lease term the freeholder would be able to dispose of the property by selling long leases of the individual flats to the existing lessees or others, in a building in a good state of repair which had been paid for by the lessees. In the present case, on the other hand, the building was in disrepair, and it was to be assumed that the lessees had no obligation to repair.

61. Nonetheless, whilst the condition of the property might be different under the two Acts, the exercise of aggregating the value of the flats was the same in both cases. The difference in the assumed condition would only be a reason to make a distinction if the flats could not be sold in their existing condition. In answer to a question from me Ms Gibbons accepted that it would have been better if Mr Still had been instructed to adjust his values to reflect the condition of the flats. Nevertheless, said Ms Gibbons, Mr Bevans had carried out that exercise, as indeed had Mr Priestly, whose approach to the adjustment for condition was not markedly different. Moreover, Mr Harrington had accepted that all the flats were habitable and he assumed that the landlords had

complied with all legal requirements as to the safety of the occupiers. Mr Bevans, too, could only have prepared the valuations that he had if he assumed that the flats could be sold in their existing state: he merely made an adjustment to reflect that condition. Furthermore, if the flats were sold on long leases in their existing condition, the leases would place an obligation on the landlord to carry out the required works of repair. The purchasers of the leases would then be responsible for contributing to the cost of such works by way of service charge and would reflect such costs in the price offered.

62. In support of her contention that the valuer was not necessarily required to assume a sale with vacant possession on the valuation date Ms Gibbons relied on the definition of the deferment rate in para 2 of *Sportelli* as:

> "the annual discount applied, on a compound basis, to an anticipated future receipt (assessed at current prices) to arrive at its market value at an earlier date."

63. The object of the valuation exercise was to assess the freehold vacant possession value at the end of the lease. It was important to bear in mind that the assumed sale at the valuation date was of the freehold reversion. Prices at the valuation date were used because they were the figures available to the purchaser at the time he calculated his bid. But there could be no assumed sale of the freehold with vacant possession at that date.

64. Ms Gibbons accepted that, in most cases, a price assessed on the basis of current values would be exactly the same as the price obtainable if the interest were sold on the market on that date. But in this case there was a distinction to be drawn between the two. That was the distinction, identified by Mr Priestly, between valuing the flats at March 2008 prices and assuming a sale at March 2008. In Ms Gibbon's submission it was the former figure which must be used when calculating the price payable under the 1967 Act. The valuation assumed a sale of the reversion. In using the vacant possession value to prepare his bid the purchaser would not be concerned that it might be difficult to sell the flats in March 2008, because he would not be in a position to sell them until 2029. Whilst the purchaser might be concerned that market circumstances would be similarly depressed when the flats were eventually sold, such risks were reflected in the deferment rate, as Mr Harrington accepted in cross examination.

65. Ms Gibbons said that Mr Harrington was not necessarily wrong to consider the price which would be offered by a purchaser who intended to refurbish the flats and sell them off. But Mr Bevans was also entitled to consider the value from the standpoint of a bidder who did not intend to sell the investment at term.

66. My conclusions on this issue are these. Mr Bevans and Mr Harrington are both very experienced valuers. Mr Harrington said that this was the first time Mr Bevans's method of valuation had been suggested to him. Mr Bevans in turn agreed that he had no evidence to support his approach. In those circumstances it would be somewhat surprising if Mr Bevans's method were correct in law. I am satisfied that it is not. I accept Mr Radevsky's submissions for the reasons that he gave. In my judgment there is no reason to depart from what Ms Gibbons accepted is the normal

practice of deferring the freehold value based on an assumed sale of that interest with possession on the valuation date. That valuation is to be carried out assuming market conditions as they were on that date. It is true that the deferment rate includes a risk premium which reflects, among other matters, the fact that the property market is volatile and that real house prices fluctuate significantly (see *Sportelli* para 76). The deferment rate therefore reflects the fact that the freehold might be resold at a time when prices are significantly below the level which would have resulted from a projection of past average growth rates. Nevertheless, while Mr Harrington rightly accepted that the deferment rate incorporates an allowance for risk, it does not follow that the starting point for calculating the open market value of the freehold interest at the valuation date is other than by reference to values at that date.

67. I do not consider there is any force in Ms Gibbon's submission that Mr Priestly's valuation approach demonstrated that the valuation was not to be based on a freehold sale with vacant possession on the valuation date. Mr Priestly's evidence was that market conditions in March 2008 would have impacted on value in two ways. Firstly, the most likely purchaser would have been a "wholesale buyer", who would negotiate a bulk discount. Secondly, the addition to the market of 12 flats for sale, at a time of limited demand, would have had a negative impact on the prices obtainable. Mr Priestly chose to quantify the effect of these two factors by making two separate deductions. That is normal valuation practice. It does not suggest that he was considering anything other than an actual sale of the appeal properties with vacant possession on the valuation date. With that consideration in mind I accept Mr Harrington's evidence that a purchaser of the freehold interests on 12 March 2008, who calculated his bid by reference to the combined values of the individual flats after he had improved them, would take into account all the costs which he would have to meet, including an appropriate profit to compensate for the effort and risk involved. In other words, he would prepare a residual valuation.

68. In his rebuttal report Mr Harrington produced residual valuations of Nos 59 and 61 which assumed, but did not accept, that the sale prices and building costs put forward on behalf of the appellants were correct. Mr Bevans made no criticism of the details of this calculation, although he did not accept that a full residual valuation should be prepared. Mr Harrington's exercise produced freehold values of £961,200 for No. 59 and £429,000 for No. 61. Those figures compare with Mr Harrington's valuations on the investment basis – which were lower than those of Mr Bevans – of £945,000 and £445,000 respectively. In fact, as became clear in evidence, the figure of £961,200 for No. 59 wrongly assumed a refurbishment cost estimate by Mr Johnson of £550,000. If the correct figure of £592,000 were substituted it is clear that the values of both the appeal properties, if purchased for the purpose of refurbishment, were lower than any of the valuations put forward on the investment basis. I therefore conclude that the best price would have been paid by a purchaser who intended to hold the appeal properties as a continuing investment. I should add that I have not overlooked the evidence of 39 Manor Road, referred to by Mr Still. In the absence, however, of any evidence as to the cost of re-converting No. 61 to a single dwellinghouse, I am unable to draw a reliable conclusion from that transaction. I now state my conclusions on valuation on the investment basis.

Valuation on investment basis

69. By the conclusion of the evidence it was common ground that the only helpful comparable evidence of residential investment sales was provided by the five Goadsby transactions. In the light of my inspection I accept Mr Bevans's opinion that the gross yield of 7.66% derived from those transactions should be reduced to reflect the fact that the appeal properties, on the East Cliff, are in a somewhat better location than any of the comparables and offer better prospects of future capital growth. On the other hand, in contrast to the position at No.61, there was no evidence that any of the properties sold by Goadsby were let to students. The ratio of net to gross income obtained from the comparables is therefore likely to have been much greater than it was in the case of No.61. In my judgment this would be reflected by the market requiring a significant increase in the gross yield from No.61.

70. Mr Harrington's view, which was expressed consistently throughout these proceedings and which was based mainly on his experience rather than specific comparables, is that the gross income of both the appeal properties would have been valued by a potential purchaser at a yield between 8% and 8½%. In view of the superior location of No.59 in comparison with the comparables I find that the gross yield applicable to No.59 would be somewhat lower than the 8% to 8½% range suggested by Mr Harrington, albeit much higher than Mr Bevans's suggestion of 5% (subsequently increased to 6%). On the other hand, notwithstanding its relatively attractive location, I consider that the exceptionally high level of outgoings which a landlord would have to incur in order to achieve the level of student rents received from No.61 would lead a purchaser to require a gross yield significantly in excess of 8½% for that property. Looking at the two appeal properties as a single investment I conclude that the range of 8% to 8½% suggested by Mr Harrington as the appropriate gross yield is about right.

71. In the absence of detailed accounts none of the comparable sales can be accurately analysed in terms of net yield. In my judgment, however, since Mr Harrington provided a broadly reliable opinion of the appropriate gross yield, his estimate of the net yield is likely also to be reliable. On the other hand Mr Bevans's suggested gross yield – 5%, increased in cross examination to 6% - cannot in my view be reconciled with the average yield of 7.66% derived from the Goadsby sales. Moreover, the credibility of Mr Bevans's evidence was not enhanced by the wide variations in the values he has put forward in the LVT and in this Tribunal. Mr Bevans did not disagree when Mr Harrington suggested at the LVT hearing that the appropriate net yield for both the appeal properties was 6%. Mr Harrington produced the same valuations at the appeal hearing and I accept them.

72. I have not overlooked the fact that Mr Priestly valued No. 59 in its existing condition at £1,000,000, which is £55,000 higher than Mr Harrington's figure. I intend no disrespect when I say that Mr Harrington's experience of the residential property market in Bournemouth at the valuation date was very much greater than that of Mr Priestly. I prefer Mr Harrington's opinion.

Relativity

73. The relationship between the existing lease values as determined by the LVT – against which there is no appeal – and Mr Harrington's freehold valuations is within the 40% to 50% range suggested by the graphs of relativity in a research document published by the Royal Institution of

Chartered Surveyors in 2009. Mr Bevans's valuations, on the other hand, would show ratios well outside that rang. Mr Bevans justified the discrepancy on the basis that relativities make no allowance for repairing obligations. This did not matter in 1993 Act cases, because it was assumed that the buildings were in the state of repair required under the lease. In 1967 Act cases, on the other hand, the property must be valued in its actual condition. He produced a table which showed that, in contrast to the position under the 1993 Act, the relativity in 1967 Act cases would vary according to the expenditure required on repairs. Mr Bevans concluded that no reliance could be placed on the relativity graphs for the purpose of the present appeals.

74. In its decision the LVT stated that Mr Bevans had confirmed that he had not previously considered that relativity graphs were unreliable when valuing houses. I accept that the treatment of necessary works of repair is different in valuations of flats and houses and that, in the case of houses in exceptional disrepair, the use of the published graphs would not necessarily be helpful. On the limited evidence on relativity which was produced in this appeal, however, I do not consider that there is any reason to depart from Mr Harrington's valuations, which I have found to be consistent with market evidence, simply because they fall within the wide range of relativities indicated by the published data.

Result

75. The appeal is dismissed. I confirm that the prices payable to the appellants for the freehold interest in 59 and 61 Grove Road, Bournemouth, are £466,300 (No. 59) and £231,400 (No. 61).

Dated 20 November 2012

N J Rose FRICS