FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference Nos:	**(1) CHI/21UC/OCE/2017/0025** **(2) CHI/21UC/OCE/2017/0026** **(3) CHI/21UC/OCE/2017/0029**
Properties:	**(1) St Emmanuel House, 6 Darley Road,** **(2) St Gabriel House, 4 Darley Road,** **(3) St Saviour House, 2 Darley Road,** **Eastbourne, East Sussex BN20 7GD (1);** **BN20 7GB (2); BN20 7GA (3)**
Applicants:	**(1) St Emmanuel House (Freehold) Limited** **(2) St Gabriel House (Freehold) Limited** **(3) St Saviour House (Freehold) Limited**

Counsel for the Applicants: Mr Stan Gallagher

Applicant's Solicitors: Dean Wilson LLP

Respondent Reversioner: Berkeley Seventy-Six Limited

Intermediate Landlord: Pennine Trustees Limited

Intermediate Landlord: Berkeley Seventy-Seven Limited

Counsel for the Reversioner: Mr Philip Rainey QC
Mr James Fieldsend

Solicitors for the Reversioner: Osborne Clarke LLP

Application type:	**Collective Enfranchisement – Application for Determination of Terms of Acquisition remaining in dispute**
Tribunal:	**Judge Professor David Clarke** **Mr Brandon Simms FRICS**
Date of Hearing:	**10, 11 and 12 January 2018**

DETERMINATIONS

1. The Tribunal hereby determines that the price payable on the collective enfranchisement of St Emmanuel House in the case CHI/21UC/OCE/2017/0025 is One Hundred and Sixty Six Thousand and Twenty Pounds only (£166,020).

2. The Tribunal hereby determines that the price payable on the collective enfranchisement of St Gabriel House in the case CHI/21UC/OCE/2017/0026 is One Hundred and Seventy Six Thousand Two Hundred and Forty Pounds only (£176,240).

3. The Tribunal hereby determines that the price payable on the collective enfranchisement of St Saviour House in the case CHI/21UC/OCE/2017/0029 is Two Hundred and Seventeen Thousand Four Hundred and Sixty Pounds only (£217,460).

The statutory determinations in respect of all three cases are set out below, together with a calculation relating to all three combined.

Address St Emmanuel House

FACTS USED

AGREED Reversion Value	£21,417		
AGREED Ground Rent 2016 to 2022	£4,000	for 5.6	years
AGREED Ground Rent 2022 to 2132	£5,152.84	for 110	years

Valuation date	21/11/16	
Deferment rate	5.00%	
Capitalisation rate	3.35%	
Unexpired term at valuation date	115.61	years

VALUE OF HEADLESSEE'S INTEREST

Capitalise ground rents

	AGREED Ground Rent 2016 to 2022				£4,000	
CR	3.35%	5.61 years			5.03808	£20,152
Increase to	**AGREED Ground Rent 2022 to 2132**				£5,152.84	
CR	3.35%	110 years	29.05495			
x Pv	3.35%	5.61 years	0.83122	**x**	24.15118	£124,447

Plus Headlessee's reversion

AGREED Reversion Value	£21,417
Value of headlessees's existing interest	£166,016
Marriage value	NIL
Compensation	NIL
Total	£166,016
Price payable say	**£166,020**

Address St Gabriel House

FACTS USED

AGREED Reversion Value	£25,960		
AGREED Ground Rent 2016 to 2022	£4,200	for 5.6	years
AGREED Ground Rent 2022 to 2132	£5,346.07	for 110	years

Valuation date	21/11/16	
Deferment rate	5.00%	
Capitalisation rate	3.35%	
Unexpired term at valuation date	115.61	years

VALUE OF HEADLESSEE'S INTEREST

Capitalise ground rents

	AGREED Ground Rent 2016 to 2022				£4,200	
CR	3.35%	5.61 years			5.03808	21,160
Increase to	**AGREED Ground Rent 2022 to 2132**				£5,346.07	
CR	3.35%	110 years	29.05495			
x Pv	3.35%	5.61 years	0.83122	**x**	24.15118	129,114

Plus Headlessee's reversion

AGREED Reversion Value	25,960
Value of headlessees's existing interest	£176,234
Marriage value	NIL
Compensation	NIL
Total	£176,234
Price payable Say	**£176,240**

Address St Saviour House

FACTS USED

AGREED Reversion Value	£36,710
AGREED Ground Rent 2016 to 2022	£5,000 for 5.6 years
AGREED Ground Rent 2022 to 2132	£6,441.05 for 110 years

Valuation date	21/11/16
Deferment rate	5.00%
Capitalisation rate	3.35%
Unexpired term at valuation date	115.61 years

VALUE OF HEADLESSEE'S INTEREST

Capitalise ground rents

	AGREED Ground Rent 2016 to 2022				£5,000	
CR	3.35%	5.61 years			5.03808	25,190
Increase to	**AGREED Ground Rent 2022 to 2132**				£6,441.05	
CR	3.35%	110 years	29.05495			
x Pv	3.35%	5.61 years	0.83122	**x**	24.15118	155,559

Plus Headlessee's reversion

AGREED Reversion Value	£36,710
Value of headlessees's existing interest	£217,459
Marriage value	NIL
Compensation	NIL
Total	£217,459
Price payable say	**£217,460**

STATEMENT OF REASONS

The applications

1. Three initial notices ("the Initial Notices"), each dated 21 November 2016, were given pursuant to section 13 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the Act") by (respectively) St Emmanuel House (Freehold) Limited, St Gabriel House (Freehold) Limited and St Saviour House (Freehold) Limited (hereafter referred to collectively as "the Applicants") seeking a collective enfranchisement of each of the three properties or blocks of flats known respectively as St Emmanuel House, St Gabriel House and St Saviour House ("the Subject Properties") situate in Darley Road, Eastbourne, East Sussex. Following completion of the statutory notice process, the parties were able to agree some but not all aspects of the terms of acquisition. Consequently, applications were made to the Tribunal in each case on 5 May 2017 for the Determination of the Terms of Acquisition in relation to each of the three claims for a collective enfranchisement.

2. The Respondents to each application are, firstly, the Freeholder and Reversioner of all three properties, Berkeley Seventy-Six Limited, and two intermendiate leaseholders in respect of all three properties, namely Pennine Trustees Limited and Berkeley Seventy-Seven Limited. These three respondents (together, "the Respondents") were represented by the same counsel and firm of solicitors and it is not necessary for the Tribunal to distinguish between them save to say that the Respondents have agreed between them that the whole of the purchase price for the collective enfranchisement in each case is payable to Pennine Trustees Limited.

The facts

3. The details of the subject properties, and the legal titles, were set out for the Tribunal firstly in the joint statement of facts agreed between the property valuers; and further elucidated in the witness statement of James Stacey, an executive director of PGIM Real Estate, a company linked to Pennine Trustees Ltd, made on behalf of both the Respondent Reversioner and the two Intermediate Landlords. It was not challenged by the Applicants.

4. As agreed by the parties, the Tribunal members did not inspect the three blocks of residential flats known as St Emmanuel House, St Gabriel House and St Saviour House, which together form the part of the former All Saints Hospital in Eastbourne, East Sussex. They sit within communal grounds on a site bounded by King Edward's Parade, Chesterfield Road and Darley Road on three sides and a public park on the western side. An underground car park and on site parking spaces are part of the development. There are 52 flats in total, 16 each in St Emmanuel House and St Gabriel House and 20 within St Saviour House. The conversion of the properties into residential flats was undertaken by the developer, Berkeley Homes, in or about 2007. The individual flat leases were granted out of the freehold for terms of 125 years from 1 July 2007. The terms of all the flat leases, the Tribunal was told, are identical and each reserves an annual ground rent of £250, with the exception of flats 1, 5, 9 and 14 of St

Gabriel House where the ground rent is £300. The Leases were granted by Berkeley Homes (Southern) Ltd. There is a management company who is a party to each lease. No issues relating to management were raised at the Tribunal hearing.

5. An important provision in all of the flat leases is that the ground rent is to be reviewed every 15 years of the term by reference to the published Retail Prices Index ("RPI"). The first review date is 1 July 2022.

6. On 17 June 2014, Pennine Trustees Limited ("Pennine"), a trust formed to acquire a portfolio of assets, purchased a large number of ground rent leases from the Berkeley group of companies. The three Subject Properties were included in that purchase. We are told that the price paid for the three properties in total was £417,341 (a figure that includes both the value of the ground rents and the reversionary value). Through the medium of the intermediate leases, Pennine became the recipient of the right to receive the ground rents of all 52 flats. The amounts currently payable for each block in total is £4,000 p.a. for St Emmanuel House, £4,200 p.a. for St Gabriel House and £5,000 p.a. for St Saviour House.

7. In the original submissions, the Applicants, through its expert valuer, was of the view that this transaction in June 2014 was not at arm's length and was probably an intergroup arrangement undertaken for tax reasons. Mr Stacey's witness statement shows that this was not the case and at the hearing it was accepted by the Applicants that the sale/purchase of the portfolio was an arm's length and open market transaction.

8. The Initial Notices seeking a collective enfranchisement, of each block separately, were served on 12 November 2016 and this is the valuation date applicable to determine the purchase price. At that date, there was 115 years and about seven and a half months (115.61 years) remaining of the 125 year term of each of the flat leases. The parties agreed within the statutory notice process that the Reversioner should have extended time for a counter-notice, in return for not making a challenge that the purchase prices specified in the Initial Notices were unrealistically low.

9. The Tribunal understands that Pennine has the right within its 'top-tier' intermediate lease to call for the transfer of the freehold and only pays a peppercorn rent. The second intermediate landlord, Berkeley Seventy-Seven, pays all the ground rent that it receives from the 52 leaseholders to Pennine. It is therefore agreed between the three Respondents that it is Pennine that has the right to the whole of the purchase price for each of the three Subject Properties.

10. There is only one specific provision in the flat leases that arose for discussion in the hearing. There is a proviso to the rent review clauses in all the flat leases relating to the rent review every 15 years to the RPI. This reads as follows:

> "But that such [reviewed] rent shall never equal or exceed such a sum as would in appropriate circumstances create an inhibition on the premium capable of being charged on an assignment of an apartment".

When this clause is referred to in the discussion below, it is referred to, as it was at the hearing, as 'the woolly proviso'.

The agreed aspects of the valuation

11. A considerable number of the matters pertinent to the valuation of the purchase price were agreed between the parties. Consequently, there was no discussion or debate at the hearing on the following aspects.

12. The value of the reversions to the long leasehold interests were agreed to be:

For St Emmanuel House:	£21,417.
For St Gabriel House:	£25,960.
For St Saviour House:	£36,710.

13. In calculating the reversionary values, the deferment rate in each case was agreed to be 5%.

14. The parties had further agreed that if the aggregate annual rents were reviewed at the valuation date to a figure taking account of the RPI increase to that date then they would be £5,152.84 for St Emmanuel House, £5,410.48 for St Gabriel House and £6,441.05 for St Saviour House.

15. With the terms outstanding at over 115 years, it was agreed that no marriage value is payable.

16. It was also agreed that no statutory compensation is payable.

The issues in dispute

17. In the statement of agreed facts prepared by the expert valuer for the Applicants, Mr Andrew Pridell, and the expert valuer for the Respondents, Mr Jason Mellor, it was concluded that the two matters that had not been agreed were the capital value of the ground rent income and therefore the overall price to be paid for the combined freehold and intermediate interests. The parties could not agree, in order to determine that capital value and the overall price, on the appropriate capitalisation rate.

18. At the commencement of the hearing, the Tribunal pointed out to the parties that there was a further very important difference between the parties, namely the method of valuation and calculation into which the capitalisation rate is to be inserted. Thus, while the parties were a long way apart on the capitalisation rate, with the Applicants contending for 6% and the Respondents for 2.9% (later adjusted by the hearing date to 3.09%), they were also taking very differing approaches to the method of valuation.

19. These differences were apparent in the opening submissions based on skeleton arguments helpfully presented to the Tribunal at the start of the three day hearing. For the Applicants, Mr Stan Gallagher of Counsel, after outlining the expert market and valuation evidence, discussed below, admitted that there was a 'stark difference' between the parties' valuers as to the weight and immediacy to be given as to how long term money market yields should inform

ground rent capitalisation rates. He said that Mr Pridell, the expert valuer for the Applicant, stressed that the Tribunal had to value a property interest and should do so in accordance with conventional property principles. He contended that, from the surprisingly little legal authority on the factors relevant to capitalisation rates (the applicable law is discussed below at paragraphs 72-78), it was clear that the weighting and application of the relevant factors was a matter of valuation opinion and judgement to be applied by an experienced property valuer. He also contended that, where, as here, the reversionary value is relatively modest, it is not possible for the risks and rewards of management to be fully reflected in the deferment rate, as is the conventional wisdom. He referred to two particular aspects relevant to the three All Saints blocks, the Subject Properties, namely the 'woolly proviso' applicable to the reviewed rents (see paragraph 10 above and discussed below) and the 'step-in risk' for the person who receives the ground rents which is applicable if the management company were to be liquidated for any reason. He therefore contended that there is a danger in concentrating on the money market prices that are paid to ascertain a capitalisation rate since the value of the ground rents is subsumed into a global sale price and it it then difficult to establish and analyse out the true value.

20. For the Respondent, Mr Rainey's core argument in his skeleton and oral opening submissions was that there was very clear market evidence provided to the Tribunal from the Respondents' valuer showing comparable open market transactions in ground rents that were relevant to these three statutory valuations. From those comparables, he submitted that one could derive the capitalisation rates that applied and could calculate accordingly. He contended that the actual valuation is a matter for a property expert and that the financial expert's role is to provide supporting expert evidence concerning the wider investment markets, yield rates and the reasons why pension funds in particular are in the market to purchase RPI linked ground rents. He contended that the valuation approach of the Applicants' valuer (Mr Pridell) was fundamentally wrong and the Tribunal should adopt the approach of Mr Mellor, the valuer for the Respondent. He had provided a basket of comparable sales around the valuation date and these had been analysed using three different valuation approaches, each of which had merit. He further took a sub-set of 15 year review cycle comparables only. The Respondent then contended for the rounded average of the six capital values thus produced and the capitalisation rate contended for as a result is 3.09%. This valuation evidence was supported by an analysis of three auction sales around the time of the valuation date which, after the same devaluation exercise, produced a range of figures that were only slightly lower than the range from the agreed private treaty sales. Finally, Mr Rainer contended that these figures could be checked by adjustment to the price paid for these ground rents in June 2014. Such an exercise produced figures well in excess of those now contended for from the values derived from the comparable evidence.

21. It should also be recorded that the terms of any transfer of the three blocks to the nominee purchasers are not yet agreed. If all three claims proceed, and there are simulameous transfers, or even a single transfer, then the Respondent will have very little interest in most of the terms of the transfer. However, if only one, or two, of the three proceed, the Respondents would have a much greater

interest in what will probably be a complex conveyancing transaction with interlocking rights and reservations impacting upon the block or blocks that the Respondents retain. The parties have therefore agreed to 'park' the terms of the transfer(s) and it is accepted that there would need to be a further hearing if the terms could not be agreed.

The financial expert evidence

22. The Tribunal heard the evidence of the two financial experts first, as it had been invited to do by the parties. Those experts were Mr Nasar Zamir, from Congruent Legal Limited, an expert on financial risk, instructed on behalf of the Applicants; and Mr Jonathan Punter, of the firm of Punter Southall, whose professional expertise is in providing actuarial and consultancy to pension schemes in the United Kingdom, instructed on behalf of the Respondents. Both experts had provided helpful written reports, with brief addendums, prior to the start of the hearing.

23. The financial expert evidence, including cross examination and questions from the Tribunal, took up a considerable amount of time on the first day. However, while such evidence was illuminating and relevant, the details explored during that evidence are not determinative of the issues that we have to decide. Moreover, the most relevant and important outcome from the evidence given was a matter on which both experts broadly agreed. Consequently, the evidence can be summarised relatively concisely.

24. In his proof of evidence, Mr Zamir set out his framework for valuation of a financial asset. Taking index linked long term ground rents as such an asset, he used UK RPI swap rates and the GB LIBOR interest rate swaps as his base. He did so since this permitted valuation from assets for periods of up to 60 years, the closest to the 115.6 years of the subject ground rents. He accepted that ground rents were not exactly the same and that ground rents had increased credit, structuring and liquidity risks. He then took the acquisition price of the ground rents of the Subject Properties in June 2014, which was £417,341, and broke that figure into its component parts, namely £355,951 for the ground rents and £61,390 for the reversionary value. From that, he derived a 'break-even spread', and then applied the time difference to November 2016 to achieve a net present value of the ground rents of £545,708. (It should be noted that were this to be taken as the value, which no-one contends that it should, the reversionary value of the three blocks at November 2016 would need to be added in, making a total would-be purchase price of £629,795, which is in excess of the amount contended for by the Respondents.) Mr Zamir then submitted that a discount would need to be applied to these particular ground rents but what that discount should be was beyond both his instructions and his expertise. However, he did conclude in his primary proof that the net present value of these ground rents would fall, after that discount, to a figure between £464,230 and £527,552, which after addition of the agreed reversionary value would amount to a range of between £548,317 and £611,639. In the addendum to his report, Mr Zamir made it clear that these figues resulted from a mathematical analyical exercise to known facts on the valuation dates and that the capital value of the ground rents in these cases was a matter of valuation judgement to be exercised by a property valuer. His was an opinion

on the investment value of an income stream equivalent to that of the total ground rents in this case, on the assumption that this income stream can be valued purely as a financial interest. Thus, these figures are not an actual valuation of the ground rents themselves.

25. The instructions given to Mr Punter, the expert financial adviser instructed by the Respondents, was not to give a valuation of ground rents but to provide supporting evidence to assist an expert valuation. His expertise is primarily in the management of funded occupational defined benefit schemes and their approaches to the investment of their assets. He demonstrated that such schemes (and those of life insurance companies) need to invest a proportion of their assets in very secure, long-dated, inflation-linked income streams which will, over that long term, match the benefits that they need to pay out. They buy to hold, so liquidity is not a major issue. Traditionally, the place for such investments has been the index linked gilt market but the yield on such gilts is now very low and there are, importantly, insufficient investments available to meet the demand, mainly because of the purchase by the Bank of England over the past few years of up to one third of the index linked gilts in issuance through its policy of quantative easing. Consequently, investment in index linked ground rents have become increasingly attractive to long term investors as they provide an alternative, very secure, long dated, inflation linked income stream. This has resulted in the value of such assets increasing significantly since 2007 with the fall in risk-free yields over the ten year period. Similar rises have been seen in other asset classes, such as long term AA rated corporate bonds.

26. Mr Punter valued the income streams from the 52 ground rents rather differently to Mr Zamir, using Bank of England inflation figures over a 25 year period. The Tribunal does not need to delve further into these different approaches because they both result in a valuation of the income stream which fall within the same valuation range. In his Addendum report, Mr Punter responded to Mr Zamir's valuation of the assets by scaling up the illustrative figures in his original report and demonstrating that Mr Zamir's valuation of the assets at each level of the spread exceeded the illustrative valuation that he had provided. But Mr Punter stressed that he did not proffer a valuation of these properties, which was a matter for a property valuer.

27. In cross-examination, Mr Zamir conceded he was not a pension expert. When pressed, he did not disagree in any way with Mr Punter's evidence relating to the market for ground rents – he simply did not know. When asked about capitalisation rates, he opined that a 6% rate was possible on the valuation date of 21 November 2016 but it would not be common and would only apply to high risk investments. Mr Punter conceded, in his cross-examination, that defined benefit and large pension funds would not be interested in a small single property with a limited number of ground rents payable but was of the opinion that they would be of interest to smaller, perhaps individual, pension funds. He also conceded that liquidity of ground rent investments can be low and that buying property was more expensive than buying a bond. However, he stressed that financial market rates do dictate what is offered in other markets.

28. The overriding relevant and important outcome from the financial expert evidence, on which both experts agreed notwithstanding their very different valaution methodologies, was that the value of an income stream, index linked, of the amount of the total of 52 flats in the three subject blocks, had substantially increased over the past decade. But valuation of the subject properties was a matter for a property valuer.

The property expert evidence of Mr Pridell

29. Mr Andrew Pridell, FRICS, was appointed by the Applicants to provide a valuation of the price payable for the freehold interest in the three Subject Properties. His worked calculations, set out in his supplementary statement, for the value of the ground rents, are £101,841 for St Emmanuel House, £110,405 for St Gabriel House and £137,240 for St Saviour House, a total of £349,486 (to which the reversionary values would be added). These figures were calculated using an equated yield calculation (referred to in the hearing as an EYC) to cover both the existing passing rents and the future reviewed rental scheme.

30. In his proof of evidence, Mr Pridell sought to justify his use of a capitalisation rate of 6% by reference to a number of factors:

(1) Tribunals consistently apply a yeild of about 8% to long lease terms with modest ground rents but 7% for leases where a ground rent doubles over a period of (say) 33 years. For ground rents at a higher level then a lower capitalisation rate reflects a more attractive investment.

(2) Property investments are different to investments in non real estate investments and risk is a keyfactor; therefore, non property market investments are not a reliable basis to ascertain the value of property investments. Thus, he took no account of Mr Zamir's report and his valuation was not informed by it. He stated in oral evidence that the change in financial markets had not been replicated in his experience of the property market.

(3) An index linked ground rent did provide a hedge against inflation but also operated to moderate or stabilise the capital value of those rents.

(4) It is difficult to derive assistance from comparable sales of other ground rents since there are many sources of income derivable from owning freeholds which might apply in such cases, such as income derivable from management, insurance, development opportunites, licences for alterations, and income from communal facilities or assignment claw-back.

(5) The procedure for recovery of small individual ground rent debt is tortuous.

(6) Property investments are not liquid and one must take account of 1987 Act rights of first refusal.

(7) Interest rates have moved back up (though he accepted this was after the valuation date) but the expectation of interest rate rises was already there and would increase the capitalisation rate.

(8) Most significantly, his firm handles thousands of cases and 6% is the predominant rate in settlements he has agreed.

(9) He cited the First Tier Tribunal (Propery Chamber) decision in *13 Andace Park* (LON/00AF/OLR/2014/0376) decided on 29 September 2016 and *Trott v Humble* ([2012] UKUT 391) where, he said, 6% or 7%

had been determined, though he pointed out that in the former, there were only two flats with shorter leases and 25 year reviews.

31. He also averred in his original proof that the sale of these Subject Properties in June 2014 could be ignored because it was not an arm's length transaction and was presumably designed to avoid tax. As noted in paragraph 7 above, this contention had been abandonned before the start of the hearing and was accepted by the Applicant as entirely incorrect. However, it was perhaps as a result of this initial misapprehension that Mr Pridell did not offer any expert comment on any aspect of that sale or its relevance or otherwise to the statutory valuations which are required.

32. In short, Mr Pridell contended that the Respondent's expert's methodology was inaccurate and not reliable from which to argue a capitalisation rate. He averred in his evidence-in-chief that no investor, in assessing whether to purchase ground rents, would take the detailed approach of Mr Mellor. Indeed, in his supplementary statement he said that a 'back of fag-packet' assessment is more the norm.

33. Mr Pridell did not supply any evidence of comparable open market transactions in ground rents that might assist his argument.

34. Mr Pridell did not supply in his proof, or in oral evidence, any details of any of the cases he referred to as settled at a capitisation rate of 6%, saying that in his experience Tribunals did not want such evidence of settlements.

35. Mr Pridell did not, in his proof, mention or take account of in his valuation of what was referred to during the hearing as the 'woolly proviso' (see paragraph 10 above) in the leases of these three Subject Properties. In re-examination, he did make some estimate of its impact, saying it would not have had much effect, between 0.1% and 0.25%. But he was unable to identify the starting percentage he would use before this adjustment would have to be made.

36. Mr Pridell had seen the Respondents expert's (Mr Mellor's) proof of evidence (discussed below) but apart from attaching a schedule of the sales evidence in that proof, he did not comment or analyse further. In particular, he did not offer any expert comment on whether the size of these comparable transactions were relevant to the sale of the All Saints Subject Properties. Only after prompting about the issue from the Tribunal did he say, in his evidence-in-chief, that each of the three blocks must be valued separately and that the market for these smaller properties would attract different investors.

37. Mr Pridell did set out a table of the relevant leases that have been supplied by Mr Mellor relating to those sales but merely annotated 'clauses that may be relevant to value' without further comment.

38. Mr Pridell did include in his proof a copy of a lease that his mother owned in a sheltered housing scheme to indicate how an assignment claw back can provide a very sizeable income to the freeholder but did not indicate in his proof, or in his evidence, what the relevance of this was to the valuation of the three All Saints Subject Properties.

39. Mr Pridell, in short, relied upon his expertise as an expert valuer specialising almost exclusively in providing advice and valuations for lease extensions and collective enfranchisements. As he said in his oral evidence-in-chief: 'I am agreeing this level of figures across the country'.

40. Mr Pridell was subject to a considerable amount of cross-examination, and to questions from the Tribunal. He had the misfortune that this extended between the first and second days of the hearing. The significant points that came out of that cross-examination are the following:

(1) Mr Pridell was challenged as to the reason why he had not checked the veracity, or later corrected, his initial view of the June 2014 sale. He accepted that in any event he had not attempted an explicit analysis of this sale.

(2) He was challenged as to how he could calculate a yield without market evidence and it was suggested to him that he was not looking at the market and his practice did not stand up to scrutiny. His answer was in the case of ground rents it was 'incredibly dangerous' to look at sale prices and do mathematical calculations since one cannot strip out the constituent parts of the comparables. He said that he could not remember the last time he looked at comparables to determine a valuation and that 'market evidence can give a disturbing result'.

(3) He was questioned as to how he could determine a capitalisation rate of 6% without reference to the market and, with yields falling and values rising (on which Mr Zamir and Mr Punter agree), it was suggested to him that should he not use that financial evidence? Mr Pridell responded that he was agreeing settlements in the market.

(4) Mr Pridell agreed that his 'back of fag-packet' approach would not apply to large investors but when pressed as to whether his 6% approach was no more that a 'back of a fag-packet' approach he responded that comparative evidence can be misleading.

(5) It was put to Mr Pridell, with detailed calculations to support, that the values for which he contended for each of the three All Saints Subject Properties actually implied a capitalisation rate of well in excess of 8% if a full equated yield (useful as a cross check) and the correct inflation assumption was applied. He did not accept that submission.

(6) It was suggested to Mr Pridell that the two Tribunal decisions that he said supported his 6% capitalisation rate did not stand up to scrutiny and that further shortcomings relating to those cases as relevant to these valuations should have been noted in his report. This was because the case of *13 Andace Park* was a case of an unrepresented landlord who had no valuation witness and no weight was given to a report suggesting 4% because the firm making the report was not called to give evidence. In *Trott v Humble*, Mr Pridell admitted that a 'dogs dinner' of a rent review clause might have been the main reason for a 7% rate.

(7) Mr Pridell was handed a schedule of 39 reported decisions in which he had been involved over a period of some 20 years where there was some statement of capitalisation rate. It was put to him that these clearly demonstrated that the rapid fall in bank base rate in 2009 had not led to an alteration of the capitaliation rate for which he had contended, which remained largely at 7%. It was suggested to him that he could not now

rely on any market sentiment that rates might be about to go up if he had never come down in the first place. Mr Pridell accepted that he had not argued for lower rates.

(8) With reference to the proof of evidence of Mr Mellor, discusssed below, Mr Pridell accepted that the interest of pension funds must be a factor in the market; and that the Subject Properties were, as with the comparables of Mr Mellor, relatively newly constructed by reputable developers. But Mr Pridell opined that things could go wrong even in new blocks.

(9) In discussion of the factors that Mr Pridell contended would impact on value, such as development potential, fees for licences, hope value or insurance commissions, Mr Pridell accepted that he did not identify any specific such matters in the comparables of Mr Mellor. It was therefore put to him that his comments on the leases supplied by Mr Mellor was not a comparable analysis and there was no basis to disregard them. Similarly, it was suggested to him that the risk of default would applied to all the comparables but it was in any event wrong to contend it was a factor since ground rent income is secure since a freeholder has the ultimate weapon of regaining vacant possession in the event of default.

41. Two final important issues were put to Mr Pridell.

(1) He had no response to make when asked about his failure to comment on the relevance of the three auction sale comparables identified by Mr Mellor.

(2) On the basis that, as he now acknowledged, the June 2014 sale was an arm's length transaction, it was put to him that if the £417,341 price paid was a market figure for the three Subject Properties combined, then one might expect the figure to increase by 19.5% in accordance with the financial evidence of the time differential. Mr Pridell appeared to accept that contention if, as he did not accept, £417,341 was an appropriate starting point for considering the value of the three blocks individually. But he did accept that there had been no change in the risk profile of these three properties during this time period.

42. Finally, in answer to some final questions from the Tribunal, Mr Pridell conceded that the comparables put forward by Mr Mellor, though mostly larger in size and in overall annual ground rent receipts than the subject properties, were part of the market; and that he had not identified any other relevant comparable evidence. He also admitted that his figure of 6% for the relevant capitalisation rate did not involve any specific adjustments. It was not refined in that way. His way was the way it was done.

The property expert evidence of Mr Mellor

43. The approach of Mr Mellor, the expert tendered by the Respondents, was different to that of Mr Pridell in every possible way though he, too, is a property surveyor and valuer, with Mauder Taylor of London, and also has been involved with leasehold reform valuations, in his case for a period of some ten years. His instructions were to undertake research of comparable evidence on the issue of ground rent values, consider general economic background information and provide expert valuation opinion.

44. Mr Mellor had two key aspects to his valuation approach. The first was that he accorded primacy to a diligent search for market evidence at or around the valuation date of 21 November 2016. That evidence was analaysed by separating out any reversionary value before undertaking the ground rent calculations. Secondly, Mr Mellor considered that all three recognised methods to calculate the capital value of ground rents where there is a regular review to RPI, namely Initial Yield applied to the passing rent ("IY"), Equated Yield applied to the passing rent to the first review and then to a current estimate of the first review rent ("EYC") and an Equated Yield applied to the passing rent until the first review and then to each period of each subsequent review, with those reviewed rents calculated by reference to an estimated long term RPI expectation ("EYF"). Since he considered each approach had merit, and provided a useful check on each other, he preferred to take the average of all the figures produced as his primary valuation figure. Even when the Tribunal invited him to produce a preferred valuation calculation, he 'stuck to his guns' and produced calculations for all his approaches.

45. The amount of, and detail of, the market evidence that he unearthed was impressive. Not only did Mr Mellor produce a schedule of 18 market sales of ground rents around the valuation date, but these were accompanied by details of each of those transactions, typically containing a transaction information sheet completed by an agent involved in the sale accompanied by a sample flat lease and registered title details. This material filled about 1600 of the 2200 pages of documents before the Tribunal in a total of five large lever arch files. As this evidence was not challenged by the Applicants, nor did they refer the Tribunal to any details of the cases or seek any elucidation of the cases put forward, it was sufficient at the hearing to concentrate on the summary schedule of such evidence.

46. Of the eighteen comparables put forward, none had an unexpired term less that 116 years and a clear majority were under 150 years. Just six were longer than 150 years, five of them close to 999 years. Seven were 15 year RPI reviews and all but one of the rest were less than that. Some were very large developments with over 100 flats (one was 570) and all except one were either larger than the All Saints Subject Properties taken separately or had formed part of a transaction for a sale that included more than one of these 18 properties. Only one, Millbrook Park, was similar in size (20 flats) and had been sold separately; but this was sold later, in July 2017, and the total passing rent was higher (£8,000) and the review frequency was 10 years. One would have expected the Applicant's expert to comment on this fact that, as individual blocks, each of the subject properties were somewhat different but it was left to the Tribunal to take up this point. Nevertheless, on an EYC basis, the capitalisation rate averaged out to 2.9% over the 18 comparables, and 3.0% for those with 15 year reviews. But Millbrook Park was higher, with a rate of 3.4% and some of the other comparables of a similar size to the All Saints blocks and closer to the valuation date, such as Minstrel Park, 27 flats and a passing rent of £6,525, and Orton Place, 28 flats and a passing rent of £4,200 each with a sale in December 2016, each with a 15 year review pattern, each resulted in an EYC capitalisation rate of 3.5%.

47. All the 18 comparable transactions were sales by private tender to specialist ground rent investors. Mr Mellor was asked whether a sale of one of the All Saints Subject Properties alone would attract interest from a specialist investor, given the size and passing rent of one of the blocks. He was of the opinion that it would and that a seller such as the Respondent would seek such a sale. Of course, the Tribunal is required to determine a statutory valuation with a willing seller, not the actual vendor, but the Tribunal is satisfied that a willing party would have available professional advice and that would mean that a sale to an specialist investor would be considered - if that was part of the relevant market.

48. Mr Mellor was not satisfied with finding sales by private treaty. He searched also for relevant auction sales, even though such sales are regarded as part of a secondary market by pension funds who would have liittle interest. He put forward three cases of blocks with more than 3 flats, long unexpired terms and where tenants had not reserved rights of first refusal. Two of these were reviews to RPI, with 10 and 14 flats and passing rents or about £3,500 – so not dissimilar to the Subject Properties, though the review frequency was 5 and 10 years respectively. The EYC capitalisation rate for those two was 3.1% and 3.3% in December 2016 and February 2017. He submitted on behalf of the Respondent that this evidence was of assistance as it showed that rates at auction produced capitalisation rates close to those in his private treaty sales comparables and an aggregate value of the subject blocks on an EYC basis of £582,296.

49. Mr Mellor was also concerned with the Appellant's contentions, put through Mr Pridell, that the comparables might be unreliable by including a premium for management or insurance opportunities (in spite of the service charge rules which should prevent profiteering). But he could find no difference in the comparable sales evidence between those cases which provided the purchaser with management or insurance and those that did not. He also considered development hope value but all the comparable evidence was for modern developments built by experienced developers so the logical conclusion is that the sites have been built to the maximum realistic capacity; and his researches did not disclose in the comparables any obvious areas of development hope value. Finally, in considering whether the comparables in the real world, where rights under the 1993 Act exist, and in the valuation assumptions in that Act, might require adjustment, he was of the opinion that a block without Act rights would be even more attractive to a pension fund investor (because of their focus on a locked away guaranteed long term income until the term date) which would have greater appeal to them since under those assumptions there could be no lease extension or collective enfranchisement which might erode the income stream. It is fair to point out on that issue that the Respondent specifically did not seek to rely in any way on any argument that value would be higher under the 1993 Act assumptions of a 'no Act' world. The Applicants, through Mr Pridell, did not challenge any of Mr Mellor's evidence or opinion about the veracity of his comparables on these issues.

50. In seeking a calculation of the amount of the market rent of the three Subject Properties, Mr Mellor's approach was to take each comparable sale, separating out the reversionary value and then undertaking an analysis of the ground rent value. He did calculations on the three separate approaches identified, namely

IY, EYC and EYF (see paragraph 44 above). The exercise was then repeated in respect of those comparables with 15 year rent reviews only. This produced a range of figures for the aggregate value of the three blocks combined of between £555,516 and £629,494 with the average of all the figures at £596,541. In his opinion, that average, which he rounded to £600,000, was primary evidence and should be followed.

50. By way of further analysis, Mr Mellor looked to the 2014 sale to the Respondent Peninne Trustees. This sale was apparently part of a multi-million transaction of many ground rents held by the Berkeley group of companies. Evidence was given that the price for the three Subject Properties was not in any way an apportionment of a larger figure. Each property in that large sale was separately valued before being included in the overall price. So Mr Mellor took the purchase price for the three blocks on 17 June 2014, £417,341, and analysed that figure with three calculation sheets, by way of, as before, IY, EYC and EYF. He then took the passage of time into account by using the 30 year National Loan Fund ("NLF") rate to find prevailing yield rates both at the date of sale and the date of valuation. This showed a reduction in yield of 1.4% between the two dates. Applying that discount to the analysed yields of the three valuation approaches, he found a average value of the three subject blocks of £642,521.

51. Consequently, Mr Mellor, taking the total aggregate value as £600,000, provided the Tribunal with calculations of each of the three blocks and submitted that the valuation of each property should be:

St Emmanuel House:	£177,754
St Gabriel House:	£190,114
St Saviour Houise:	£232,132.

52. Under cross examination, Mr Mellor stressed his opinion that ground rents provide the income sought by institutional investors and that the subject properties are of the quality they seek. He robustly defended his use of all three valuation approaches, contending that all have some merit and some disadvantages where the rental amount is unknown at future dates. He preferred not 'to hang his hat on any one peg' when seeking a value based on market sales. Mr Gallagher put to him that his approach to capitalisation rates meant that such rates were 'locked in' for the remainder of the term which caused valuation difficulties. Mr Mellor did not accept that point – it is the current market.

53. He was also asked about the information set out in his Appendix JM5 that tabulated the choice of capitalisation rate in a series of Tribunal decisions. Just three were identified as being ground rents linked to RPI and he was asked why his capitalisation rate was so much lower than those three. He responded that it was because he had looked at the directly comparable market evidence. When pressed that institutional investors might 'overbid' other property investors who might be more aware, Mr Mellor said he could not comment. He was also of the opinion that that the institutional investor was not concerned about being 'locked in' after buying at a price that might reduce if yields rose in the future, since the purchase was made to hold in the long term against long term inflation linked liabilities. Finally, Mr Mellor did not accept that the institutional

investor was 'buying in a different market'. Whether buying at auction or by private treaty, all purchasers will be mainly influenced by the long term cash flow element.

The submissions of the Respondent

54. Mr Rainey, for the Respondents, noting that a separate valuation was required for each of the three subject properties, but that the separate valuation of each superior interest had been agreed (with the freehold of the Reversioner Berkeley Seventy-Six Ltd and the intermediate interest of Berkeley Seventy-Seven being agreed in each case at £0), said it was common ground that those three valuations, of the premium payable to Peninne Trustees, would be decided by the capitalisation rate that the Tribunal determined was appropriate to apply.

55. He referred the Tribunal to the cases of *Sportelli* and *Gallagher*, more fully discussed at paragraphs 72-76 below, cases that in his view made it clear that the primary method of determining the value should be the relevant market evidence.

56. His submission was firmly centred on the fact that his client had produced land valuation evidence whereas Mr Pridell, for the Applicant, had produced none. He submitted that, while it was obviously correct to take account of all the relevant factors that might impact on the risks of investing in ground rents, it was the market that properly took account of all those expectations. Mr Mellor had produced uncontroverted evidence of relevant property tranactions and Mr Punter's evidence explained the reasons why that evidence of values was at the level indicated. In short, the Tribunal should rely on the evidence submitted, and the financial evidence explains it. He specifically relied for that submission on *Sportelli*, duscussed below, and *Munday v Sloane Stanley Estate Trustees* [2016] UKUT 223, upheld by the Court of Appeal [2018] EWCA Civ 35. Even if the Tribunal considered that such evidence was in any way distorted or not directly comparable, the correct approach was to start with the evidence and apply appropriate discounts if required. The main difference here might be the review patterns but Mr Mellor had accounted for that by also averaging all the 15 year review comparables.

57. He submitted it was wrong to apply any discount because of the presence of the 'woolly proviso'. He referred to the case of *Kutchukian* (see paragraph 78 below) and on the authority of that case submitted that if the Tribunal was minded to discount because of its presence, then the Tribunal needed to take a view as to its meaning. If one had to do so, he submitted that it was confined to covering the possible reintroduction of Rent Act limits because of the use of the word 'inhibition'; but in fact there was no evidence to suggest that, whatever its meaning, that it would impact on valuation.

58. He submitted that the evidence produced on behalf of the Respondent had been produced to 'court standard' and was verified in each case in a conventional manner. The comparables included properties in large portfolios, small portfolios and individual cases. The Millbrook comparable was closest in size and each individual block of the three Subject Properties would sit 'just off

the bottom' of the comparables cited. The auction sales reinforced the position and the very worst (from the Respondent's point of view) relevant capitalisation rate was 3.5%. The Subject Properties were recent quality builds and would sit within these parameters.

59. It was pointed out that the evidence was entirely one-sided. There was therefore no market evidence from the Applicant's valuer to justify any adjustment or discount by the Tribunal. Moreover, the concept of a 'willing party' was there primarily to remove the impact of personal foibles. A willing seller would be well advised and prudent so would not ignore the market for ground rents from pension funds and similar investors. Indeed, Mr Rainey considered that the actual vendor in this case would be a good proxy for a willing seller.

60. On the valuation methodology adopted by Mr Mellor, the Tribunal was urged to recognise that property valuations by cash flow analysis did not make them any less of a property valuation. The Tribunal may need to adopt one approach for its statutory valuation and that should probably be the EYC approach. Nevertheless, Mr Mellor should be commended for testing his valuation in three different ways and not abandoning this approach even when the highest figures came from an EYC analysis.

61. The Respondent does not, said Mr Rainey, rely on the level of the sale price of 17 June 2014 transaction to justify its valuation at November 2016. But the Tribunal was asked to note that the Applicants valuation in total for the three blocks was less that was paid in 2014; and if the 2014 figure was properly adjusted, it comes out higher than the valuations that are now proposed by the Respondent. Mr Pridell had agreed a 19% upwards adjustment in the agreed value of the reversions but then argued that prices for the property as represented by the income stream had not only not risen but had fallen despite accepting there had been no change in the risk profile.

62. The headline point urged by Mr Rainey was that the figures put forward by Mr Pridell were merely an opinion without reasoning, and without market evidence or analysis. The Applicants and Mr Pridell knew at an early stage that the Respondents' approach to these cases was to be different to what had gone before yet they chose not to engage with the evidence submitted by Mr Mellor. It was also a serious demerit that Mr Pridell did not inform his opinion using the evidence of Mr Zamir. Ignorance is not an advantage and his 'back of the fag-packet' approach had been challenged and was inappropriate.

63. Concluding, Mr Rainey submitted that the Tribunal should accept Mr Mellor's valuation in full. There was nothing in the evidence of Mr Pridell to challenge it and any distorting factors in the comparables would have 'stuck out' from the others, but no suggestion had been made that that was the case or that any of the comparables were unreliable.

The submissions of the Applicants

64. Mr Gallagher, in his closing submissions on behalf of the Applicants, reminded the Tribunal of the requirement to carry out a statutory valuation of

what might be expected to be sold in the market with each individual block to be sold and valued separately. The Act does not define market rent and while Mr Gallagher did not deny that institutional sales by private tender were open market sales, the key question was whether such sales were within the relevant market. In this respect, there were three strands to his submissions:

(1) Institutional investors were in a different market where they were not concerned about long term capital value;
(2) That institutional market looks primarily to longer term income generation from larger properties with a substantial income streams;
(3) The Subject Properties fall into a different market where income streams are smaller and Mr Pridell knows that market.

65. To enter the institutional market for ground rent income, there were two broad criteria for access, namely the scale of the properties and the quality of the assets. While these properties would not fail the quality test, they did fail the scale test. The Millbrook comparable was closest but, it was submitted, not close enough, with £8,000 in passing rent comared to £4,000 or £5,000 for the subject properties. So while the comparables are not criticised in themselevs, they came from the wrong market. The small scale investor is not buying for the very long term or to match liabilities. They are more concerned with the risk (which they cannot spread across a large portfolio) and long term capital value. Further, Mr Gallagher submitted that, while discount for risk was normally done in the deferment rate (which had been agreed), risk elements should also feature in the capitalisation rate where, as here, the reversionary value is relatively low and the ground rent income relatively high. Smaller investors wish to avoid gyrations in capital value.

66. Reliance was placed on *Gallagher v Walker*, analysed more fully below at paragraph 75.

67. The capitalisation rate contended for, at 6%, permits long term stability and Mr Rainer' criticisms of the range of cases where Mr Pridell has been involved is unfounded. Stability is, and should be, a feature of those markets and Mr Pridell's consistency is a strength of his valuation evidence, not a concern. The property market is a supertanker not an inshore boat capable of variable speeds.

68. The correct valuation method is by EYC thus avoiding the uncertainty of guessing long term RPI rates. Mr Pridell's approach is to be preferred as he is vastly experienced and has acted in great volumes of transactions. A mathematical cash flow analysis may be appropriate for financial instruments but expertise is to be preferred and the application of that expertise shows 6% rate is correct. That is the advice that would be given to a potential freehold investor in the relevant market.

69. The Applicant's prime contention is for a price of £349,485. The June 2014 purchase by the Respondent was at £417,391 which is contended to be part of the 'investors' market. However, while the Applicants prime contention is for £349,485 were the Tribunal to accept the June 2014 value as relevant then in view of the 19% rise in capital values over a 29 month period, the Applicants secondary contention would be for £498,727 for the three blocks, conveniently a mid point between each party's figures.

70. As for the 'woolly proviso', Mr Gallagher took a different view of the authority of the case of *Kutchukian*, see below paragraph 78. Consequently, he considered a small discount should be applied by the Tribunal and he was asking for a discount of between 0.1% and 0.25%.

71. The Tribunal notes that Mr Gallagher did not, in his closing submissions, consider the three auction comparables put forward by the Respondent.

The relevant law

72. A useful starting point is perhaps the case of *Arbib v Earl Cadogan* [2005] 3 EGLR 139, a decision of the Lands Tribunal. The actual decision has been overtaken by the case of *Sportelli* (discussed below) but we were taken to the comment in that case on the approach to valuation where Judge Rich QC concluded:

"The courts and this Tribunal have considered market value on many occasions . . and have, in effect, given explanations that add to, or put a gloss on the brief definitions found in the statute. . . A valuer preparing a valuation under . . . any statutory valuation must value to the statutory definition as explained by the relevant case law . .".

73. It is therefore important to reiterate the statutory definition applicable to the valuation of the freehold interest for a collective enfranchisement in Schedule 6, paragraph 3(1) of the Leasehold Reform, Housing and Urban Development Act 1993:

"the value of the freeholder's interest in the specified premises is the amount which at the relevant date that interest might be expected to realise if sold on the open market by a willing seller".

(It should be noted that though the valuation is technically for an intermediate interest held by Peninne Trustees, Schedule 6 paragraph 7(1) says that paragraph 3 should apply to determine the value; and as it is agreed that the price for the freehold and the second intermediate interest shall be nil, the Tribunal is effectively valuing as if it were the freehold).

74. The parties are agreed that there is very little if any authority to assist this Tribunal in determining the main issue in dispute for valuation purposes, namely the capitalisation rate to be applied. However, various authorities were put before us, often the same from both sides, though somewhat different conclusions were drawn.

75. Mr Gallagher, in contending that Mr Pridell's approach was fully in accordance with valuation principles, referred to the decision of the Court of Appeal in *Gallagher v Walker* (1974) 28 P&CR 113, an early enfranchisement valuation case under the Leassehold Reform Act 1967, that doubted whether, as a matter of valuation principle, the financial money market was a safe guide to valuing an interest in land (per Lord Denning at p117). We were also referred to comments of Sir Eric Sachs (at p121), commenting on the fact that both valuers in that case had sought to find the correct multiplier by going into the market and basing the answer on long term interest rates. He referred to the danger of doing that in times of very high interest rates – and Mr Gallagher contended

that it was equally dangerous in a time of very low interest rates. However, Mr Rainey responded that the case also confirms the primacy of market evidence, of which there was none in that decision. Sir Eric Sachs said (again at p 121):

"I would respectfully endorse the observation of Lord Denning MR *arguendo* when he said that one must look primarily to the land market and to the money market only as a factor".

We consider that final observation to sum up the views of the Court of Appeal in that decision.

76. Both parties acknowledged that the well known Court of Appeal decision in *Earl Cadogan v Sportelli* [2007] EWCA Civ 1042 did not assist us directly in determining the disputed capitalisation rate dealing, as it did, with the proper deferment rate to be applied to vacant possession value and the proper valuation of any hope value. However, we were referred by Mr Rainey to the decision in that case in the Upper Tribunal where, at paragraph 8, after referring to the two issues in dispute, it was said:

"We are not concerned with the other element in the value of the reversion, the ground rent and how it should be capitalised. Nothing said in this decision has any direct application to capitalisation rates. Market evidence should be more readily available for those".

Mr Rainey also pointed out that a financial model was the basis for the decision in *Sportelli* on deferment rates; for if market evidence cannot be relied upon, then money market evidence is admissible.

77. It was accepted by both sides that the factors relevant to the ascertainment of the capitalisation rate are manifestly different to those that are to be applied to assess a deferment rate: *Nicholson v Goff* [2007 1 EGLR 83. In that case, a number of factors were stated to be relevant to the determination of a capitalisation rate – the lease length, the security of recovery, the size of the ground rent, whether there is provision for rent review and the nature of any review provision. Mr Gallagher was of the view that these were all self evident and the weighing and application of them was a matter of valuation opinion and judgement to be applied by an experienced property valuer (such as Mr Pridell); and the additional element absent from this list was the degree of risk attaching to reversionary residential ownership and management. The Tribunal comments that this is undoubtedly a good list of relevant factors, but in the schedule of comparables provided by Mr Mellor many of these factors were the same. All were of terms in excess of 115 years remaining, and all could be taken as having the same security of recovery issues (at least there was no evidence to the contrary). All had a provision for rent review to the RPI and the differences in the size of the ground rent was taken into account in the analysis of the figures. Only in the length between review dates were there differences that could impact on value and Mr Mellor sought to test the results by only taking 15 year review patterns. In any event, as Mr Rainey contended, to take account of any of these factors one must first derive a rate from market evidence, which Mr Mellor sought to do.

78. On the issue of what has been termed the 'woolly proviso', we were referred to the case of *Kutchukian v Keepers (etc) of the Free Grammar School of John Lyon* [2013] EWCA Civ 90, [2013] 1 WLR 2842, especially at 2855E. On the authority of that collective enfranchisement case, where a very different point

was at issue but related to a clause which was uncertain in its effect, Mr Rainey contended that the Tribunal should not discount for uncertainty but, if necessary, take a view as to what the legal position was and not treat the legal position as uncertain. However, he further submitted that the Tribunal did not have to take a view on the meaning since there had been no evidence or argument put forward by the Applicant as to how it might affect value. If he was wrong, then he contended the 'woolly proviso' should not attract a discount since the use of the word 'inhibition' clearly pointed to it being applicable only in the situation of reimposition of Rent Act controls. Mr Gallagher responded by contending, in his closing submission, that the Tribunal did have to grasp and take a view on the legal position; and suggested that Lewison LJ at p2860 might have taken a different approach. The Tribunal prefers the submission of Mr Rainey and in particular considers that it is not necessary in any event to decide the exact extent of the clause since there was no evidence put forward by the Applicant as to how it might impact on value.

Reasons for preferring the submissions of the Respondent

79. In the light of the legal principles enunciated above, the Tribunal has no hestitation in preferring the evidence of the Respondents and adopting their approach to valuation.

80. There was a vastly different approach between the parties, presenting the Tribunal with a clear choice of which to adopt. Mr Gallagher valiantly and cleverly argued for a recognition of two different markets, where the values differed substantially. He contended that the statutory valuation should reflect a market, secondary to that where institutional investors sit, where purchasers are smaller investors as much concerned with the long term capital value of their investment as with an income stream. Such investors would not be moved by what was happening in the money markets and by prices paid by large investors in a time of very low income streams looking for inflation protected returns to match on going inflation linked liabilities. In that secondary market, it was the advice and practice of expert valuers such as Mr Pridell that held sway and whose opinion of that secondary market was decisive.

81. The problem for Mr Gallagher in sustaining that argument is that the experts tendered by the Applicants gave him very little material on which to base his approach. Mr Zamir's evidence supported that of Mr Mellor in agreeing that money market values on streams of inflation protected income had risen substantially. Mr Pridell did not provide to the Tribunal even a shred of market evidence (as opposed to his expert opinion) to support the contention of Mr Gallagher that there were two distinct markets – nor did he challenge in any effective way the market evidence of the Respondents. For a valuer to be heard to say in evidence that it was 'incredibly dangerous' to look at sale prices, and in his supplementary proof of evidence to aver that "'back of the fag-packet' assessment is more the norm" is frankly astonishing. The Tribunal regrets to record that the Applicants have not been well served by their expert valuer.

82. However, even if there had been valuation evidence to support Mr Gallagher's contention for a secondary market, the Respondent's unchallenged evidence, particularly relating to the Millbrook comparable, would suggest that

such a secondary market (if true) would not exist with the chasm between values that is shown by the rival contentions in this case – namely an aggregated price for the three Subject Properties valued separately of £349,485 for the Applicants and £600,000 for the Respondents. The Applicants had to accept, as they must, that the June 2014 sale, though as part of a very large portfolio, was an open market transaction and were then left to argue that when considering a sale of one block of the three, that the statutory valuation should reflect a move into a very different market at a much lower value. But the most difficult part of the evidence, which was unchallenged and does not fit Mr Gallagher's vision of two very different markets, is the evidence of three auction sales. Even if one discounts the transaction that was of a property where the ground rents were not linked to RPI, the other two show, at the very least, that an auction sale of one of the subject blocks at the valuation date would probably have produced a value largely in line with the Respondents' contentions with only a modest reduction in the derived capitalisation rate.

83. The Tribunal found the weight of the Respondent's evidence compelling. Mr Punter gave illuminating evidence of the financial background to the comparable market evidence and the Tribunal accepts that pension funds, insurance companies and some unit trusts have moved into the market over the last decade to purchase high quality recently developed property let to leaseholders at long terms with index linked ground rents. His knowledge explained the level of market comparables produced by Mr Mellor. No doubt, in this case, the Respondents both have the financial muscle, and the motivation, to come to the Tribunal with weighty evidence of transactions that are relevant to the dispute. But the evidence so produced has not been challenged as to its veracity or relevance to the market for ground rents which have the scale and quality to be of interest to institutional purchasers.

84. Turning to the methods of valuation, the Tribunal was impressed by Mr Mellor's approach to valuation. It is logical, reasonable and compelling. He tested the comparable evidence by seeking what the capitalisation rate should be from each transaction that he could locate. He checked the average so produced by taking only those with 15 year reviews. He then declined to apply only one method of calculation even though, from his comparables, the EYC method produced the highest figure and the one most favourable to the Respondents. He considered each valuation calculation had some merit, and some disadvantages. Consequently, the Tribunal accepts that his averaging of all the results to produce an overall value for the three blocks combined of £596,541, which he rounded up to £600,000, should be adopted. The Tribunal takes his conclusion as the starting point for the detailed stautory valuation that is required.

The Tribunal's determination

85. Before undertaking the statutory valuation and concluding our determination, the Tribunal considered if it was appropriate to discount or modify the conclusions of the Respondent's valuer.

86. The first point to note is that the Tribunal does not give credence to Mr Gallagher's secondary submission that the Tribunal should take the price paid in June 2014 and merely inflate that sum by an agreed rise in capital values. The resulting figure might be somewhere between the two parties contentions on valuation but the Tribunal's role is not to prefer some median conclusion – unless the weight of evidence points that way. In this case, the Tribunal finds that the Respondents' submissions are to be supported and the Applicants' contentions that there are two very distinct markets where the values are radically different cannot be supported by the evidence.

87. The discussions at the hearing about the 'woolly proviso', which had not been raised in the paperwork but only surfaced in the opening submissions of the Applicants, led, at the end of the hearing, for a contention by Mr Gallagher that the Tribunal should make a minor discount of between 0.1% and 0.25% in the capitalisation rate it would otherwise determine. The Tribunal declines to make such a discount. There is no evidence that such clauses would result in such a modification and that is sufficient for our conclusion. But we also accept Mr Rainey's submission on this point.

88. If the Tribunal then accepts Mr Mellor's valuation of the three properties together at £600,000 then the relevant capitalisation rate comes out at an EYC capitalisation rate of 3.0907%. However, the figure of £600,000 is a rounded one, increased from his average of £596,541. The Tribunal does not accept that this is the place to do the rounding. We have to determine the correct capitalisation rate for each statutory calculation of each of the three subject properties. Rounding may be appropriate when the resultant figure is known.

89. More pertinently, there is the issue of scale. The Tribunal does not accept Mr Gallagher's argument of two very distinct markets but the evidence of the Respondent's valuer does suggest that where there are sales of properties with a ground rent stream of somewhat lower proportions, then there is some minor increase in the capitalisation rate that is derived from the purchase prices recorded. Thus, Millbrook Park contained 20 flats and had a total passing rent of £8,000 and a review frequency of 10 years and the EYC capitalisation rate was 3.4%. However, with a valuation date of July 2017, it should not be given too much weight on its own. More relevant are the properties known as Minstrel Park and Orton Place, sales in December 2016, with 27 and 28 flats respectively, a passing annual rent total of £6,525 and £4,200 and each with a 15 year review frequency. The EYC rate in those two cases were 3.5%. If one looks at the two auction sales with with RPI reviews, with only 14 and 10 flats respectively and a total passing rent in each case of less than £4,000 in each case, the relevant EYC rates are 3.2% and 3.5%. It is the case that the largest comparable, St Andrew's Hospital, with 570 flats and a passing rent of £160,650, also capitalised out at 3.2% and some of the other comparable sales of larger scale properties were also at this level. However, when all the smaller scale properties are above the average, the Tribunal considers it should take some notice of that evidence.

90. The Tribunal is not assisted by the fact that the Applicant's Counsel made no submissions on this point. But the Tribunal, during the evidence of Mr Mellor, put to him that there was a small difference, taking his comparables as

a whole, between the larger blocks and the somewhat smaller ones with fewer flats and a lower annual passing rent. He accepted that there was a small discrepancy. In his closing submissions, Mr Rainey refered to an EYC rate of 3.2% when looking at the comparables referred to in the previous paragraph which are 'bang on line'. He acknowledged as well that the very worse of them (from his point of view) was 3.5%.

91. The Tribunal concludes that the right approach is to accept the Respondent's evidence and the approach to calculation adopted by Mr Rainey. However, it considers that for the statutory valuations for each of the Subject Properties the capitalisation rate should be adjusted slightly to reflect the fact that the value being sought is of a block with 16 or 20 flats and a passing rent of between £4,000 and £5,000. On the evidence before the Tribunal, a discount from an average capitalisation rate of 3.09% to a rate of between 3.2% and 3.5% would be appropriate to reflect the size and scale factors. The Tribunal determines the capitalisation rate at 3.35% which is the midpoint figure of the rate applicable to and derived from the evidence from properties of a similar scale to the Subject Properties.

92. Applying a capitalisation rate of 3.35%, and rounding each of the resultant figures as in the detailed calculations set out in our determination at the commencement of this statement of reasons:

(1) The Tribunal hereby determines that the price payable on the collective enfranchisement of St Emmanuel House in the case CHI/21UC/OCE/2017/0025 is One Hundred and Sixty Six Thousand and Twenty Pounds only (£166,020).

(2) The Tribunal hereby determines that the price payable on the collective enfranchisement of St Gabriel House in the case CHI/21UC/OCE/2017/0026 is One Hundred and Seventy Six Thousand Two Hundred and Forty Pounds only (£176,240).

(3) The Tribunal hereby determines that the price payable on the collective enfranchisement of St Saviour House in the case CHI/21UC/OCE/2017/0029 is Two Hundred and Seventeen Thousand Four Hundred and Sixty Pounds only (£217,460).

93. The total amount payable for the three Subject Properties combined is therefore £559,720.

Closing remarks

94. The Tribunal is aware that discontent has been expressed by some leaseholders and commentators, in the national press and elsewhere, on the practice of reserving ground rents of more than nominal sums in new developments and making these rents reviewable at future dates. Some examples put forward might seem to suggest that such arrangements can sometimes impact heavily on both the value and saleability of the leasehold properties subject to such rents. No such concerns have been expressed before us in relation to the Subject Properties.

95. Nevertheless, the Tribunal expects the leaseholders in the Subject Properties who were the Participating Qualifying Tenants and who gave the

Initial Notices through their Nominee Purchaser to claim a collective enfranchisement to be disappointed at the level of the price determined by the Tribunal. The Tribunal wishes to stress to them that its duty is to apply the law as determined by the Act and by Parliament. Institutional investors may have entered the market and increased the prices paid for streams of ground rent income, and thereby increased the value to be paid on a collective enfranchisement, but the Tribunal's duty is to determine the amount that that interest might be expected to realise if sold on the open market by a willing seller. It is ultimately for Parliament to decide whether and to what extent regulation might be required to limit ground rents from residential long leasehold properties being a valuable income stream.

Right of Appeal

96. A person wishing to appeal this decision to the Upper Tribunal (Lands Chamber) must seek permission to do so by making written application to the First-tier Tribunal at the Regional office which has been dealing with the case.

97. The application must arrive at the Tribunal within 28 days after the Tribunal sends to the person making the application written reasons for the decision.

98. If the person wishing to appeal does not comply with the 28 day time limit, the person shall include with the application for permission to appeal a request for an extension of time and the reason for not complying with the 28 day time limit; the Tribunal will then decide whether to extend time or not to allow the application for permission to appeal to proceed.

99. The application for permission to appeal must identify the decision of the Tribunal to which it relates, state the grounds of appeal, and state the result that the party who is making the application for permission to appeal is seeking.

Judge Professor David Clarke
7 February 2018