

**LEASEHOLD VALUATION TRIBUNAL FOR THE
LONDON RENT ASSESSMENT PANEL**

**DECISION OF LEASEHOLD VALUATION TRIBUNAL
ON AN APPLICATION UNDER S21 OF THE LEASEHOLD REFORM ACT 1967**

Applicant: The Wellcome Trust Ltd

Respondents: Mr & Mrs N Ahmad

Re: 6 Pelham Street, London SW7 3NG

Application Date: 12 November 2003 by Landlord

Hearing Date: 10 and 11 August 2004

Inspection Date: 17 September 2004

Appearances: Mr S Schaw Miller of Counsel
Miss D Drummond Brassington, Solicitor, Cameron McKenna
Miss S Patel, Trainee Solicitor, Cameron McKenna
Mr R Cullum FRICS FIRPM, Cluttons
Mrs A Jacques, Property Investment Manager,
The Wellcome Trust Ltd
for the Applicant

Mr R G McDonald LLB MRICS, The McDonald Partnership
for the Respondents

Members of the Leasehold Valuation Tribunal:

Mrs J S L Goulden JP (Chairman)
Mr D L Edge FRICS
Mr W J Reed FRICS

Date of Tribunal's decision: October 2004

LON/LVT/1671/03

PROPERTY: 6 PELHAM STREET, LONDON SW7 3NG

BACKGROUND

1. The Tribunal was dealing with an application by the Applicant landlord, The Wellcome Trust Ltd, to determine the price payable by the Respondent tenants, Mr and Mrs N Ahmad, for the freehold of 6 Pelham Street, London SW7 3NG (hereinafter referred to as "the subject property") under Section 9(1C) of the Leasehold Reform Act 1967 (hereinafter referred to as "the Act").
2. The subject property is held under a lease dated 7 January 1987 for a term expiring at midsummer 2046 at variable rents rising to £3,700 per annum.
3. The following matters were agreed:-
 - (a) The valuation date was 4 September 2003
 - (b) The unexpired term of the lease was 42.75 years
 - (c) The Gross Internal Area of the subject property was 2022 sq ft
 - (d) The Gross internal Area of development potential was 781 sq ft
 - (e) The capitalisation rate was 6%
 - (f) Relativity was 70%
4. The issues which required the determination of the Tribunal were as follows:-
 - (a) The value of the freehold interest with vacant possession**
 - (b) The development value of the potential second floor**
 - (c) The appropriate deferment rate**
5. The Applicant's expert contended for an enfranchisement price of £307,000 which he amended during the Hearing to £317,500. The Respondents' expert contended for an enfranchisement price of £250,000 which he amended during the Hearing to £264,000. Their respective valuations are attached as Appendices B and C.

HEARING

6. The Hearing took place on 10 and 11 August 2004.
7. The Applicant, The Wellcome Trust Ltd, was represented by Mr S Schaw Miller of Counsel, Miss D Drummond Brassington, Solicitor, and Miss S Patel, Trainee Solicitor, both of Cameron McKenna, Mr R Cullum FRICS FIRPM of Cluttons and Mrs A Jacques, Property Investment Manager of the Wellcome Trust Ltd.
8. The Respondents, Mr and Mrs N Ahmad, attended and were represented by Mr R G McDonald LLB MRICS, who also gave expert evidence.

Value of the Freehold Interest

9. Mr Cullum said that Pelham Street is a discrete market with two discrete sub-markets. The busy road and the open station cutting were features which give the western side (even numbers) a set of circumstances which were not replicated elsewhere. On the eastern side the houses immediately adjoin the railway cutting at the rear and this is a less favourable circumstance. This, he said, was reflected in the following summary of sales of freehold interests -

No.	GIA	Price	Date	£ / sq ft	£ / sq ft updated by Savills PLCSW Houses Index
14	2733	£1,250,000	7/03	457	463
18	2797	£1,500,000	6/02	536	519
20	1747	£1,025,000	5/03	586	594
24	2982	£2,250,000	12/00	754	793
51	1510	£662,500	6/01	438	427
55	1320	£498,000	1/01	377	396

10. In Mr Cullum's opinion No. 20 was the best comparable, being a stuccoed terraced four storey house in a very similar style to the subject property. Nos. 14 and 18 were five storey houses of a different style, and No. 24 was a double house which had been subject to extensive modernisation.

11. The updated sale price of No. 20 devalued at £594 per sq ft, but the sale particulars indicated that this property had a more conventional layout than the subject property. Mr Cullum had therefore adopted a rate of £530 per sq ft for the subject property - an allowance of about 10% - to arrive at a value for the existing area of the subject property of £1,071,000.
12. Mr McDonald also relied upon the sales of Nos. 14, 18, 20 and 24/26, but had made adjustments, also based on Savills PCLSW Houses Index, to arrive at slightly different rates per sq ft, and further adjustments in respect of Nos. 14, 20 and 24 to reflect the condition of those properties at the dates of sale. He had also included the sale of No. 16 Pelham Street in January 2004 for £1,100,000, equivalent to £362 per sq ft.
13. Mr McDonald's adjusted rates were as follows -

<u>No.</u>	<u>GIA</u>	<u>Adj sale price</u>	<u>Condition</u>	<u>Adjustment</u>	<u>Comp. value</u>	<u>Comment</u>
20	1747	£589.22	Moderate	£50 p sq ft	£539 p sq ft	
18	2797	£527.11	Unimproved	-	£527 p sq ft	
14	2733	£463.38	Refurbished	£100 p sq ft	£363 p sq ft	Blighted? Allsops thought so.
16	2933	£362.51	Unimproved	--	£362 p sq ft	Blighted?
24	2982	£793.21	Excellent	£200 p sq ft	£593 p sq ft	Date of sale

14. Having reconsidered the evidence, and increased the adjustment for condition from £25 to £50 per sq ft in respect of No. 20 during the hearing, and including the adjusted devalued rate of £593 per sq ft for No. 24 (which had previously been excluded because of the condition of the property and the historic date of sale) Mr McDonald arrived at a revised average rate of £477 per sq ft, which he rounded to £480 to give a capital value for the subject property of £970,560.
15. Mr McDonald said that he had spoken to the selling agent of No. 14, who was of the opinion that the property achieved a low price because the buyers had been aware of the possibility of the station development. He also thought that the sale of No. 16 in January 2004 had been similarly blighted.

Development Value

16. Mr Cullum considered that the property could be enlarged by 781 sq ft by the provision of an additional storey at 2nd floor level with a mansard roof - as had been carried out at the other houses in Pelham Street. A previous planning application had been granted for the provision of an additional storey, and in his opinion there was little doubt that a fresh application would be granted.
17. He said that in central London it is conventional to value potential development value at site value rates which are, generally, 50% of the developed value. On this basis he had initially calculated the additional value at £206,965 (781 sq ft @ £265 per sq ft - being 50% of his rate of £530 per sq ft for the remainder of the house), but during the hearing he revised his rate for the extension to £295 per sq ft to produce an additional value of £230,395. He said that he had adopted the higher value because the additional development would be newly built with modern facilities, and more in line with his best comparable, 20 Pelham Street, which he had devalued at £594 per sq ft.
18. Mr McDonald agreed that the property had potential for extension at second floor level. He also agreed that this would increase the floor area by 781 sq ft, but considered that the site value should be taken at 45% of the developed value to reflect the relatively low value of the properties in Pelham Street, and the type and cost of the development. He had therefore taken 45% of £450 per sq ft to arrive at a development value of £158,000
19. Both valuers agreed that the full cost of carrying out the development should be deducted from the value of the completed development before applying the 70% relativity factor to arrive at the value of the leasehold interest before enfranchisement.

Yield

20. In his original valuation and in his amended valuation Mr Cullum had capitalised the ground rent at 6% and had deferred the reversion at 5.25%.
21. He said that yields for capitalising rents and for deferring reversions had been agreed or determined at 6% for many years. It had been the almost automatically adopted rate on most of the major estates, but it had seemed to him, and to some other (mainly

landlords') valuers, that this uniform rate was unrealistically high. The country had enjoyed a low interest / low inflation economy for too long for this not to have had an impact on investment yields. He considered that over a long period returns would reflect movements in Bank Base Rate.

22. Mr Cullum said that a major problem for both practitioners and tribunals had been identifying the evidence. It was impossible to analyse sales of reversionary interests without knowing the purchasers' opinion of the vacant possession value, and the decision of the Court of Appeal in *Gallagher v Walker* had made it clear that relying on the money market to determine yields was not acceptable.
23. But now, he said, there is market evidence. The discontinuance by the Housing Act 1988 of new regulated tenancies under the Rent Act 1977 after February 1989 had freed up the residential investment market. As a result the market is growing, it attracts major players and has been analysed and measured for some time.
24. Mr Cullum said that there are two authoritative indices. FPD Savills had produced the Savills Prime Central London Gross and Net Yields table. A copy of this table had been included as an appendix to the 'hearing bundle' and showed that gross and net yields for PCL houses at September 2003 were 4.6% and 2.4% respectively. He said that Cluttons is a sponsor of this Index and provides factual information, but he was unable to explain how the Index is compiled or to provide any examples of the factual information provided.
25. Investment Property Database (IPD) also produced an index, and a copy of its index at the end of 2002 had also been included as an appendix to the bundle. This index showed that at the end of 2002 the gross and net yields for 825 properties in Central London, having a capital value of £34.9m, were 5.9% and 3.3% respectively. The notes state that this Index is compiled from valuation and management records for individual units collected from investors by IPD. All valuations used in the Residential Index are conducted by qualified valuers working to RICS guidelines, and that the valuations used in performance measures are investment values which traditionally stand at discount to vacant possession values. A copy of the Index at the end of 2003 provided during the hearing showed yields of 5.6% and 3.5%.

26. Mr Cullum said that these yields reflected investment returns arising from the letting of freehold and long leasehold property at rack rents, and later confirmed that the Index measures the return of assured shorthold rents against the vacant possession values of the properties concerned.
27. He then compared the risks of a rack rented investment with the risks of a reversionary investment. He considered that both types of investment would benefit (or suffer) equally from any movement in capital values, that voids were peculiar to the rack rented sector, that there was less risk of default with a reversionary interest, that for the rack rented sector the prospect of rising or falling rents was a two edged sword and that there was less risk with reversionary investments where rents were usually tiny and fixed.
28. He accepted that an investor in a reversionary investment has to decide at the outset what the average yield is going to be over the unexpired term of the lease, and found it difficult to accept that yields for reversionary investments should be substantially higher than those for rack rented investments.
29. Mr Cullum said that there is a ready market for reversionary investments, but provided no evidence of actual sales of either reversionary or rack rented investments. Even if there was no third party evidence he considered that a reduction in rates was the logical consequence of a long period of low interest rates and low inflation. The FPD Savills Index showed a trend of falling yields from about 1995 onwards. He said that the evidence now exists and could not be ignored; the acceptance of change is a gradual process, but he was aware of a number of settlements where the 6% "mould" had been broken and there was acceptance that yields had fallen.

30. He referred to the following six settlements in which he had been involved -

Property	Type	Years unexpired	Capitalisation	Deferment	Tenant's Agent
1 Pelham Place	House	95	5.5	5.75	Simon Davies
76 Elm Park Road	House	48.8	5.5	5.5	Justin Bennett, Langley Reiff Byers
12 Egerton Terrace	House	31.25	5.0	5.5	Brian D'Arcy Clark, Chesterfield
15 Lennox Gardens Mews	House	49	5.5	5.5	C J Roberts, Lamberts
21 Vale Court	Flat	9.5	4.5	5.5	A Bishop, Bishop Beamish
1 Elm Park Chambers, 275 Fulham Road	Flat	9.75	4.5	5.5	D Radford, Knight Frank

31. Mr Cullum said that the analyses were his, and that supporting evidence had been included in the bundle. This comprised copies of letters from the lessees' valuers, and copies of Mr Cullum's analyses.
32. Mr Cullum then explored a further reason why, in his opinion, the use of deferment rates of 6% or more in quality residential areas was demonstrably wrong. That is that in valuing the freehold reversion the yield must take into account hope value.
33. He said that the Act requires the valuation of both the tenant's and the landlord's interests to be made on the assumption that the Act "conferred no right to acquire the freehold." Without the Act, therefore, no purchaser would pay any element of hope value or marriage value over and above the 'natural' value of the remaining term. Without the Act the landlord is in a very different position. His asset is growing in value daily; he is under no pressure to deal with the tenant and is in total control.
34. Mr Cullum said that in the absence of the Act there was no chance of a freeholder disposing of his interest at a figure which simply represented the capitalised rent and the deferred reversion. On a sale to a third party the landlord would require a share of the latent value to be released in negotiation with the tenant and the purchaser would be willing to pay that share. He said that this 'hope' value, or, in reality, near certainty, of being able to realise and capture the marriage value is not precluded by the Act and in his view must, therefore, be included.

35. This is achieved by reflecting the likelihood of the excess payment in the yield used to defer the reversion. Mr Cullum said that although Leasehold Valuation Tribunals had been reluctant to accept argument for moving below 6%, and that Leasehold Valuation Tribunal decisions in respect of 40 Chelsea Square and 1 Tryon House had been appealed to the Lands Tribunal, others had had greater success. He referred the Tribunal to paras 74 to 77 of the Lands Tribunal's decision in *Cadogan Holdings v Pockney and Pockney* in respect of 57 Shawfield Street, London SW3. In that decision Mr N J Rose FRICS had found that the rate of 5.25% suggested by Mr Gibbs was "not too low" In Mr Cullum's opinion this suggested that a figure lower than 5.25% would have been correct at Shawfield Street.
36. Mr Cullum also referred to the Lands Tribunal's decision in respect of Flat 6, 32 Brechin Place, London SW7 in which Mr N J Francis had reduced the LVT's deferment rate from 7% to 6.25%.
37. Mr Cullum said that since these Lands Tribunal decisions the vast majority of agents and valuers with whom he negotiates have accepted that 5.25% on the South Kensington Estate is 'not too low', and provided the following schedule of deferment yields which had been agreed by him or by his colleagues in South Kensington, Knightsbridge and Chelsea. All of these settlements were post the Lands Tribunal decision on Shawfield Street.

Property Address	Tenant's Valuer	Deferment Yield Agreed
4 Herbert Crescent	Robert Orr-Ewing Knight Frank	5.25%
32 Ennismore Gardens Mews	George Pope FRICS	5.25%
31 Sumner Place	Angus Fanshaw Douglas & Gordon	5.25%
13 Alexander Square	Brian D'Arcy Clark Chesterfield	5.25%
17 South Terrace	Peter Hawkes Mellersh & Harding	5.25%
10 Sloane Avenue	James Wilson W A Ellis	5.25%

18 Walton Place	Robert Orr-Ewing Knight Frank	5.25%
Flat 1, 39 Lennox Gardens	Robert Orr-Ewing Knight Frank	5.25%
Flat 3, 5 Ennismore Gardens and First Floor, 1A Cranley Gardens	Prosper Marr Johnson Marr Johnson & Stevens	5.25%
Flat 4, 35 Egerton Gardens	James White Douglas & Gordon	5.25%
46 Pont Street Mews	Andrew McGillvray W A Ellis	5.25%
4 Tite Street	Daniel Hutton Marshall Hutton	5.25%
Third Floor, 16/17 Ennismore Gardens	Michael Boyle Boyle & Co	5.25%
Flat 10, 49 Onslow Gardens Styles Harold Williams	Peter Turner	5.25%

38. In addition there had been two other settlements where the figures had been agreed but there had been no specific agreement on the make up.
39. He therefore believed that the case had clearly been made for a reduction in rates. In this case he considered that a capitalisation rate of 6% was appropriate to reflect the doubling of ground rents, and that a deferment rate of 5.25% was appropriate to reflect the nature of Pelham Street and the uncertainty attached to the proposed development of the station site opposite.
40. Mr Cullum considered that although properties in Pelham Street have relatively low capital values due to the blight caused by the uncertainty arising from the proposed development of South Kensington Tube Station, the street will dramatically improve over the period of the lease, the rate of growth will be greater than the market generally, and this would drive the yield downwards.
41. He provided the Tribunal with a copy of an article which had appeared in **Property week** on 6 August 2003 headed 'Fear and Loathing in South Kensington' which referred to the

South Kensington Underground Development Action Group (SKUD) opposition to Stanhope's plans to develop the tube station. Mr Cullum considered that some less intensive form of development would be permitted for the following reasons - an alternative scheme had been supported by English Heritage, London Transport was desperate for funds, the site was zoned for development on the Urban Development Plan, the developer had already spent a vast amount of money and central government was keen to see the site developed.

42. Mr McDonald had capitalised the ground rents at 6% and had deferred the reversion at 6%. He referred to a Leasehold Valuation Tribunal decision dated 20 June 2004 in respect of 55/57 Cadogan Square (LON/ENF/1004/04) in which the Tribunal had determined a rate of 6% for the deferment of the freeholder's reversion in June 2076. This was in respect of a property of a more valuable type and in a more prime position than Pelham Street. Mr McDonald was aware of the Lands Tribunal's decision in respect of Shawfield Street, but relied upon the more recent LVT decision.
43. He also referred to a File Note dated 21 January 2004 of a meeting between Mr Cullum and Mr Simon Davies that they had provisionally agreed a valuation in respect of 1 Pelham Place which reflected a capitalisation rate of 5.5% and a deferment rate of 5.75%. He added that Pelham Place was superior in all respects to Pelham Street.
44. Mr McDonald said that in spite of rising interest rates since January 2004, Cluttons were now asking for deferment rates of 5.25% based largely on the Shawfield Street Lands Tribunal Decision. He said there had been many settlements incorporating yields of under 6% and he had concluded two recently, but it had to be appreciated that if lessees fight for a realistic yield and win they are aware that the landlord may well appeal, and the costs of a Lands Tribunal appeal are daunting for private individuals. It is therefore the overall price rather than its analysis that prompts a lessee to accept or to reject a settlement.
45. Mr McDonald also said that at the valuation date it was well publicised that the Bank of England would be increasing interest rates in the coming months as a result of consumer spending and property price rises. It would not therefore have been a time when a decrease in property yields would have been appropriate.

46. Mr McDonald said that there was no evidence of transactions and that yields are not subject to simple market evidence; it is also necessary to rely on the experience and the expertise of the surveyors involved. He considered that the improvement of Pelham Street had to be taken with a pinch of salt. He said that although yields had dropped, interest rates had risen five times in the past fifteen months. The property market does not react rapidly to interest rate changes, and he did not consider that the period of low interest rates had been long enough to reduce yields.
47. Mr McDonald said that he had recently negotiated a settlement and had agreed to include 5.25% in the report but this had been offset by an agreed higher relativity. He said that the 5.25% was of concern because it provided a dividend to the landlord. He said that almost all settlements have "*an element of horse trading*". He had spoken to other valuers who were equally concerned, and it had been suggested that they should form a 'Tenants' Surveyors Association'. They had found no evidence that 5.25% was correct.
48. He agreed that there will be a development on the tube station site; he considered that it will need to be substantial to cover the infrastructure costs, and that it will take at least five years to complete.
49. Mr McDonald said that the evidence of his clients was that they did not want to be involved in reversionary investments because of the timing, the loss of control and the tying up of capital. He accepted that they could sell earlier if they wished, but the timing would need to be right and there were costs of sale and reinvestment to be taken into account.

INSPECTION

50. The subject property was inspected by the Tribunal on 17 September 2004 and was a three storey (including lower ground) mid terrace house circa 1860 situated in a very busy and noisy road which was also a bus route and opposite Kensington Station, from which constant noise from trains was noted.
51. The accommodation was as described in Mr Cullum's witness statement of 2 August 2004. In the Tribunal's view the layout was unusual and inconvenient with mainly dated

kitchen and bathroom fittings. Some of the rooms had poor natural light. Some minor external disrepair was noted.

52. The Tribunal noted from the front bedroom windows the pleasant open view to the far side of the railway cutting.
53. The rear patio area was severely overlooked by the rear of Malvern Court, an eight storey mansion block with an unsightly external metal fire escape. The noise from the trains was clearly audible within this rear patio area.
54. The Tribunal inspected, externally only, the following properties:-

14, 16, 18, 20 and 24 Pelham Street
1 Pelham Place
57 Shawfield Street
32 Brechin Place

DECISION

Value of the Freehold Interest

55. The Tribunal carefully considered the valuation evidence provided by the sales of the properties in Pelham Street. It agreed with Mr Cullum that No. 20 was the most comparable in appearance, but noted that it had a GIA of 1747 sq ft including a second floor. Mr Cullum had made an allowance of approximately 10% for a more conventional layout, and Mr McDonald had made an adjustment of £50 per sq ft (or 8.4%) for 'condition' at the date of sale.
56. Nos. 14,16 and 18 are of a different design and much larger than No. 20. Copies of the particulars of sale had been provided for these three properties in which No. 14 had been described as 'newly refurbished to a high standard' and No. 16 as being ' in need of modernisation'.
57. Mr McDonald had suggested that the sales of Nos. 14 and 16 had been blighted by the proposed station development but produced no firm evidence to support this view.

58. In the Tribunal's opinion the evidence is inconclusive, but on the evidence available, the Tribunal attaches rather more weight to the sale of No. 20 as being the most comparable but smaller than the others and with a better internal layout. The Tribunal considers that a rate of £500 per sq ft fairly represents the value of the existing house at the valuation date. The property has an agreed GIA of 2022 sq ft, and the Tribunal's valuation of the existing building is, therefore, £1,011,000.

Development Value

59. Both valuers agreed that the property could be extended by 781 sq ft by the provision of an additional storey at 2nd floor level with a mansard roof, as had been carried out at the adjoining properties. They also agreed that the full cost of carrying out the development should be deducted from the value of the completed development in the calculation of the value of the leasehold interest before enfranchisement, and that the leasehold interest had a relativity of 70% to the value of the freehold interest with vacant possession.
60. Their differences related to the value per sq ft of the completed development and the percentage to be taken as the site value on a 'standing house value' basis.
61. The Tribunal has determined that the value of the existing building with vacant possession is equivalent to £500 per sq ft. It considered Mr Cullum's reasons for the use of a higher rate per sq ft for the additional development, but, although the additional development will be newly built with modern facilities, it is at second floor level with a mansard roof and will form part of the enlarged but unmodernised house. The comparables all have similar extensions which have been included in the sale prices, and are therefore reflected in the analysis.
62. The Tribunal therefore considered that it is appropriate to value the completed extension at the same rate per sq ft as it had applied in its valuation of the remainder of the property.
63. The Tribunal also considered that in the absence of a detailed development appraisal or any other information it would be appropriate in this case to follow convention and to adopt 50% of the value of the completed development as the value of the site on a 'standing house value' basis.

64. The Tribunal therefore determines that the development value, based on an additional area of 781 sq ft, is £195,250, that the total value of the freehold interest is £1,206,250, and that the value of the leasehold interest, based on an agreed relativity of 70% and after allowing the full cost of the additional development, is £785,800.

65. The Tribunal's calculations are as follows -

	<u>Freehold Interest</u>	<u>Leasehold Interest</u>
Value of existing building	£1,011,000	£707,700 (70%)
Development value (781 sq ft x £500 = £390,500 x 50%)	<u>£195,250</u>	
(£390,500 x 70% = £273,350 - £195,250)		<u>£78,100</u>
	<u>£1,206,250</u>	<u>£785,800</u>

Yield

66. The Tribunal considered very carefully the arguments and the evidence provided by the expert witnesses. It is conscious that 'yield', and particularly 'deferment yield', is a contentious issue. The Tribunal was aware of the Lands Tribunal's decisions in respect of 57 Shawfield Street, SW3, and Flat 6 32, Brechin Place, SW7, and that at least three other Leasehold Valuation Tribunal decisions had been appealed to the Lands Tribunal.

67. However, each Leasehold Valuation Tribunal must reach its decision on the evidence before it, supplemented by its own knowledge and experience, and, as was pointed out during the hearing, decisions of the Lands Tribunal on matters of valuation (although persuasive) are not regarded as precedents or binding in any way on Leasehold Valuation Tribunals. This was made quite clear at paragraph 77 of the Lands Tribunal's decision in respect of 57 Shawfield Street.

68. The Tribunal therefore considered the evidence under the following headings -

- (a) FPD Savills' Index
- (b) The Investment Property Database (IPD)

- (c) Mr Cullum's comparison between rack-rented and reversionary investments
- (d) The market for reversionary interests
- (e) The agreed settlements and supporting correspondence and valuations
- (f) Hope value in the 'no Act' world
- (g) The schedule of settlements at 5.25%
- (h) The effect, if any, of the tube station development.
- (i) The Lands Tribunal's decisions

(a) FPD Savills' Index of Prime Central London Gross and Net Yields.

69. Mr Cullum provided a copy of Table 3, which shows that gross and net yields for PCL houses in September 2003 were 4.6% and 2.4% respectively. It also shows that yields had fallen from previous highs of 9.5% and 6.2% in December 1992 and 8.1% and 5.1% in December 1988. Quite clearly the Table forms part of FPD Savills' Residential Data, but no background notes were provided, and Mr Cullum was unable to explain how the Index had been compiled. The Tribunal considers that the Table may reflect the gross and net returns on properties held as investments at the relevant dates, and is therefore portfolio based rather than transaction based. It shows the yield on properties held as investments, and will reflect the fall in rental values following September 11 2001 and the considerable rise in capital values since that time - which inevitably result in lower yields. In the Tribunal's opinion the yields shown in the Index do not, therefore, necessarily represent the yield which a purchaser in the open market would have been prepared to accept in September 2003.

(b) The Investment Property Database (IPD)

70. Mr Cullum had provided copies of the IPD Index for the end of 2002 and for the end of 2003. At the end of 2002 the gross and net yields for 825 properties in Central London were 5.9% and 3.3% respectively. At the end of 2003 the yields were 5.5% and 3.5%. The notes to the Index state that the residential index shows annual time-weighted returns calculated by chain-linking monthly returns to capital employed for market standing investments. Standing investments are properties held from one valuation to the next. The notes to the Index state that the valuations used in performance measures are investment values, but to determine these values it would have been necessary to predetermine the yield rate. Mr Cullum, however, confirmed that the Index reflected the yield from rents of assured shorthold tenancies against vacant possession values. This

index is, therefore, also portfolio based rather than transaction based, and again in the Tribunal's opinion does not necessarily reflect the yield which a purchaser would be prepared to accept in an open market transaction at the valuation date.

(c) Mr Cullum's comparison between rack-rented and reversionary investments

71. Mr Cullum set out to establish whether a reversionary investment carried with it more or less risk (and therefore a higher or lower yield) than a rack rented investment.
72. The Tribunal accepts Mr Cullum's analysis, but considers that, although there may be less risk of voids and default with reversionary investments, the downside is the complete absence of any prospect of rental growth and little or no prospect of obtaining possession until the end of the term - and even then the tenant may have a statutory right to remain in possession. Even if the investor sold his investment before the end of the lease, the same disabilities would apply to a purchaser and would be reflected in the price which he would be prepared to pay.
73. On balance therefore, the Tribunal considers that a rack rented investment is more attractive than a reversionary investment, and that this would measurably, if not substantially, reduce the yield rate for the former.

(d) The market for reversionary interests

74. Although Mr Cullum said that there was a ready market for reversionary interests (which the Tribunal took as meaning an active market), he produced no evidence of actual sales of reversionary investments.

(e) The agreed settlements and supporting correspondence and valuations

75. Mr Cullum referred to six settlements with which he had been involved, and shown at the table at paragraph 30 above. This shows capitalisation rates of 4.5% where the lease had only 9.5 and 9.75 years unexpired, and 5.5% at 48.8 and 95 years unexpired. It also shows a deferment rate of 5.75% for 1 Pelham Place and 5.5% for the remainder.

76. Mr Cullum said that the analyses were his own, but he included copies of correspondence to show that the rates had been acceptable to the lessees' agents.
77. In respect of 1 Pelham Place, the tenant's agent Simon Davies, in a letter dated 1 February 2004, referred to his meeting with Mr Cullum on 21 January 2004, and confirmed that he had now received his client's instructions and had been authorised to agree the enfranchisement price of £154,000. There was no mention in that letter of capitalisation or deferment rates, but the Tribunal was provided with a copy of a file note of the meeting prepared by Mr Cullum which referred to a capitalisation rate of 5.5% and a deferment rate of 5.75% - as shown in the table.
78. In respect of 76 Elm Park Road, P S Levy & Co, Solicitors, in their letter of 4 February 2004 confirmed their clients acceptance of their earlier agreement at £850,000. They then went on to say -

"You have advised us that as a condition of settlement of this matter you require confirmation on the part of our clients that they agree the deferment rate at 5.5% and we confirm that purely for the purpose of settling this matter we are instructed by our clients that they so agree".

The Tribunal considers from the above wording that, having agreed the sum to be paid, the deferment rate was incidental.

79. The Solicitor, Brian D'Arcy Clark of Chesterfield, in his letter of 20 June 2003 relating to 12 Egerton Terrace said under the heading 'Discount Rates' -

"You have chosen to use rates of 4% and 5% for capitalisation and discount, whereas I would normally apply 6%. I would be prepared to recommend 5% and 5.5% respectively".

It appears from the tone of his letter that he was trying to reach a compromise agreement. Attached were copies of his original and amended valuations, both clearly marked 'without prejudice'.

80. A letter from Lamberts dated 20 July 2000, and headed 'Subject to contract' and 'Without

prejudice' in respect of 15 Lennox Gardens Mews, confirmed that Mr Roberts had applied a rate of 5.5% throughout to produce a revised valuation of £357,000.

81. Finally a letter dated 28 January 2004 from David Radford of Knight Frank merely confirms that he had been instructed by his client to offer the sum of £167,000 plus statutory recoverable costs, but made no mention of either capitalisation or deferment rates. Attached to this letter is a copy of Mr Cullum's analysis of the agreement to show a capitalisation rate of 4.5%.
82. Having reviewed this correspondence the Tribunal is not persuaded that any of the lessees' representatives necessarily agreed, or even accepted, the capitalisation or deferment rates suggested by Mr Cullum as shown in his analyses.

(f) Hope value in the 'no Act' world

83. The Tribunal accepts that in the 'no Act' world the landlord had complete control, and it was to remedy this imbalance that the legislation was introduced, firstly for houses in 1967 and then for flats in 1993. In this case the lessees are exercising their rights to enfranchise under the 1967 Act, as amended, and the basis of valuation is set out in s.9(1A) as follows -

".....the price payable for a house and premises..... shall be the amount which at the relevant time the house and premises, if sold in the open market by a willing seller, might be expected to realise on the following assumptions -

(a) on the assumption that the vendor was selling for an estate in fee simple, subject to the tenancy, but on the assumption that this Part of this Act conferred no right to acquire the freehold or an extended lease and that the tenancy will terminate on the original term date."

84. Section 9(1C) provides that the price payable for a house and premises where the right to acquire the freehold arises by virtue of any one or more of the provisions of sections 1A or 1B above shall be determined in accordance with subsection (1A) above; but in any case -

"(a) if in determining the price so payable there falls to be taken into account any marriage value arising by virtue of the coalescence of the freehold and leasehold interests, the share of the marriage value to which the tenant is to be regarded as being entitled shall not exceed one half of it".

85. The statutory basis therefore provides for the landlord to receive the open market value of his reversionary interest on the assumption that the tenant has no right to acquire the freehold or an extended lease, and not less than 50% of the marriage value, if any.
86. To include 'hope value' in the valuation of the landlord's reversionary interest to reflect the hope that the tenant may wish to acquire the freehold or to extend his lease is clearly contrary to the spirit of the Act and to the requirements of s.9(1A)(a), and to include 'hope value' in the valuation of the landlord's interest would be a duplication of payment of the marriage value and contrary to s.9(1C)(a).
87. The Tribunal does not, therefore, accept that 'hope value' should be included in the valuation of the landlord's interest.

(g) The schedule of settlements at 5.25%

88. For each of the sixteen settlements shown on the schedule referred to in paragraph 37 above, where the deferment yield is shown as having been agreed at 5.25%, the Tribunal has been provided with the address of the property and the name of the lessee's valuer, but it has not been provided with full details of the individual cases to enable it to consider the circumstances underlying the agreement, or any other documentation or evidence to show conclusively that 5.25% had been mutually agreed between the parties in each case.
89. Mr McDonald had said that he had recently negotiated a settlement and had agreed to include 5.25% in his report in exchange for an agreed higher relativity, and that if lessees "fight" for a realistic yield the landlord may well appeal and the costs of an appeal to the Lands Tribunal are daunting for private individuals.

90. Against this background, and in the absence of any other evidence, it seems likely that the lessees' valuers may have felt compelled to agree a valuation which could be analysed by the landlord to show a deferment rate of 5.25%, possibly in exchange for a higher relativity, or to face the prospect of a reference to a Leasehold Valuation Tribunal and possibly to the Lands Tribunal with all the costs that that may involve.

91. In these circumstances the Tribunal attaches little weight to these settlements.

(h) The effect, if any, of the tube station development

92. Mr Cullum considered that, with the development of the tube station site, Pelham Street would improve over the period of the lease, and that this should be reflected in the yield. Mr McDonald was more sceptical about the nature and timing and effect of the proposed development, which in his opinion would take at least five years. The Tribunal considers that both experts are correct. There may be an improvement in the longer term, but at some stage, and possibly for five years, living conditions could become unpleasant and disrupted. In valuation terms the Tribunal considers that the advantages and disadvantages are evenly balanced.

(i) The Lands Tribunal's Decisions

93. The Tribunal was provided with copies of the following Lands Tribunal decisions -

Cadogan Holdings v Pockney & Pockney (2004)
Re : 57 Shawfield Street, London SW3
A decision of Mr N J Rose dated 16 April 2004

Day & Day (2004) (No Respondent)
Re : Flat 6, 32 Brechin Place, London SW7
A decision of Mr P R Francis dated 19 April 2004

Blendcrown Ltd v The Church Commissioners for England (2003)
Re: 25-31 Hyde Park Gardens and 22-35 Stanhope Terrace, W2
A decision of Mr P H Clarke dated 15 December 2003

94. In the Shawfield Street decision Mr Gibbs had argued before the Leasehold Valuation Tribunal that the reversion should be deferred at 6%, and the Tribunal decided that Mr Gibbs' figure was right.

95. The tenant then appealed to the Lands Tribunal, and Mr Gibbs argued for a deferment yield of 5.25%. He relied upon various indices and settlements to persuade the Tribunal that 5.25% was 'not too low', and Mr Cullum considers that had Mr Gibbs contended for an even lower rate he would have been successful.
96. In the Brechin Place decision, where the lessees did not respond to the appeal, the evidence again referred to indices and settlements and the Tribunal was persuaded that a capitalisation rate of 7.25% and a deferment rate of 6.25% were correct in that case.
97. In respect of 25-31 Hyde Park Gardens and 22-25 Stanhope Terrace, the Leasehold Valuation Tribunal had determined a capitalisation and deferment rate of 6% as at the valuation date of 3 March 2002, as contended for by Mr Anthony Ford MRICS for the Church Commissioners. The Lands Tribunal determined a capitalisation and deferment rate of 7% as at a valuation date of 11 May 2001 and 6.5% at 3 April 2002 to reflect falling interest rates as at that date.
98. So far as can be seen from the decisions, no evidence of actual market transactions was produced in either of these appeals, and the Tribunal is aware that the lessees of Flat 6, 32 Brechin Place, having purchased the leasehold interest with the benefit of the outstanding claim, did not proceed with the enfranchisement at the price determined by the Lands Tribunal and have very recently agreed the amount to be paid for the landlord's abortive costs.
99. Mr Cullum said that it was impossible to analyse sales of reversionary interests without knowing the purchaser's opinion of the freehold vacant possession value. The Tribunal suggests that even if that figure was known it would still be impossible to analyse the sale to differentiate between the capitalisation and deferment rates. It therefore seems to this Tribunal that to differentiate between these two rates is inappropriate since they are inseparable. The purchase of a freehold reversion is one transaction comprising two elements and the Tribunal considers that the vast majority of purchasers / investors would look for one overall return on their investment, and that the analysis of actual sales and the preparation of valuations should be approached on that basis.
100. Both parties had capitalised the ground rents at 6%, and having considered the circumstances in respect of 6 Pelham Street and having inspected externally the

properties at 1 Pelham Place, 57 Shawfield Street and 32 Brechin Place, the Tribunal is satisfied that the deferment rate in this case should not be less than 6%.

PREMIUM

101. The Tribunal determines that the premium is £275,550 and the Tribunal's valuation is attached as Appendix A.

CHAIRMAN..........

DATE..... 6 October 2004

6 Pelham Street, London SW7

Valuation in accordance with sections 9(1A) and 9(1C) of the Leasehold Reform Act 1967, as amended, as at 4 September 2003 - the date of the Notice of Claim.

A. Value of freehold interest

Ground rent 4/9/2003 to 23/6/2007 YP 3.75 yrs @ 6%	£925 p a <u>3.2671</u>	£3,022
Ground rent 24/6/2007 to 23/6/2028 YP 21 yrs @ 6%	£1,850 p a <u>11.7641</u> £21,763.58	
PV £1 3.75 yrs @ 6%	<u>0.8111049</u>	£17,653
Ground rent 24/6/2028 to 23/6/2046 YP 18 yrs @ 6%	£3,700 p a <u>10.8276</u> £40,062 12	
PV £1 24.75 yrs @ 6%	<u>0.2507202</u>	£10,044
Reversion to unimproved freehold interest with vacant possession PV £1 42.75 yrs @ 6%	£1,206,250 <u>0.0828541</u>	<u>£99,943</u> £130,662

B. Marriage value

Value of unimproved freehold interest with vacant possession after enfranchisement		£1,206,250
<u>Less</u>		
Value of freehold interest before enfranchisement	£130,662	
Value of leasehold interest before enfranchisement	<u>£785,800</u>	<u>£916,462</u>
Marriage value		£289,788
50% of marriage value		£144,894

C. Premium

Value of freehold interest	£130,662
50% of marriage value	<u>£144,894</u>
	£275,556
Say	£275,550

Appendix B

6 Pelham Street

Freehold value				1,301,000
Rent	925			
Y.P. $3\frac{3}{4}$ @ 6%	3.27	£3,024		
Review to	1,850			
Y.P. for 21 yrs deferred $3\frac{3}{4}$ @ 6%	9.46			
			17,501	
Review to	3,700			
YP for 18 yrs deferred $24\frac{3}{4}$ @ 6%	<u>2.56</u>			
			9,472	
Reversion to	1,301,000			
PV £1 in $42\frac{3}{4}$ @ 5.25%	<u>0.112</u>			
		145,712	175,709	
Leaseholder's interest			842,000	1,017,709
Marriage value				283,291
		+ 2		141,645
Freeholder's interest				<u>175,709</u>
				317,354
			Say	317,500

Appendix C

Your ref: LON/LVT/1671/03

6 PELHAM STREET, SW7

Based on GIA of	2022 sq. ft.			
Expiry of Lease	23/06/46	Val Date	04/09/03	
1 VALUE OF GROUND RENT				
GROUND RENT		925.00		
YEARS UNEXPIRED	42.80			
PERIOD TO FIRST REVIEW	3.80			
YIELD ON INVESTMENT	6.00%			
YEARS PURCHASE	<u>3.3110</u>		3,063	
REVIEWED RENT		1,850.00		
PERIOD TO REVIEW	21.00			
PV OF YP	<u>9.427</u>		17,440	
REVIEWED RENT		3,700		
PERIOD TO EXPIRY	18			
PV OF YP	<u>2.552</u>		<u>9,443</u>	
VALUE OF GROUND RENT			29,946	
2 REVERSION OF HOUSE	480	970,560		
POTENTIAL INCREASE TO GIA	781			
DEVELOPMENT VALUE	45%	216	168,696	
VALUE UNIMPROVED			1,139,256	
YIELD ON INVESTMENT			6.00%	
UNEXPIRED TERM			42.8	
P. V. OF REVERSION		<u>0.0826</u>	<u>94,083</u>	
LANDLORDS PRESENT VALUE			124,029	
3 MARRIAGE VALUE				
LONG LEASE VALUE		1,139,256		
EXISTING LEASE VALUE	70.0%	679,392		
DEVELOPMENT VALUE ADDED		56,232		
LANDLORDS P.V.		<u>124,029</u>		
MARRIAGE VALUE			279,603	
4 PRICE PAYABLE				
LANDLORDS PRESENT VALUE			124,029	
50% MARRIAGE VALUE			<u>139,802</u>	
5 TOTAL				263,830
			SAY	264,000
VALUE OF COMPLETED DEVELOPMENT	781	480	374,880	
VALUE OF SITE		45%	168,696	
ESTIMATED COSTS OF DEVELOPMENT			206,184	
RELATIVE VALUE OF IMPROVEMENTS		70%	262,416	
VALUE ADDED TO EXISTING LEASE			56,232	