UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – dwellinghouse – price – whether correction certificate validly issued – held it had not – whether freehold to be valued in two stages or three – three stage approach held to be appropriate - capitalisation rate for modern ground rent – deferment rate – appeal allowed – price increased to £12,600 – Leasehold Valuation Tribunal (Procedure) (England) Regulations 2003 – Leasehold Reform Act 1967, s9(1)

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

BY

CLARISE PROPERTIES LIMITED

Re: 167 Kingshurst Road
Northfield
Birmingham
B31 2LL

Before: The President and N J Rose FRICS

Sitting at: 43-45 Bedford Square, London, WC1B 3AS
on 14 December 2011

Georgia Bedworth, instructed by SE Law Ltd, solicitors of Northwich, Cheshire for the appellant.

The following cases are referred to in this decision:

Mansal Securities Ltd's Appeal LRA/185/2007, 24 February 2009, unreported
Zuckerman v Trustees of the Calthorpe Estate [2010] 1 EGLR 187
Bristol-Myers Squibb Co v Baker Norton Pharmaceuticals Inc [2001] EWCA Civ 414
Chelsea Properties Ltd v Earl Cadogan LRA/69/2006, 2 October 2007, unreported
Haresign v St John the Baptist's College, Oxford (1980) 255 EG 711
Cadogan v Sportelli [2006] RVR 382
Cadogan v Sportelli [2008] 1 WLR 2142
Farr v Millersons Investments Ltd (1971) 22 P&CR 1055
Marlodge (Monnow) Ltd's Appeal LRA/28/2002, 25 November 2002, unreported
Mayfly (Corrib) Ltd's Appeal LRA/29/2002, 25 November 2002, unreported
Freehold Properties Ltd's Appeal UKUT 172 (LC), LRA/150/2008 11 September 2009, unreported

DECISION

Introduction

1. This is an appeal by Clarise Properties Ltd against a decision by the Leasehold Valuation Tribunal for the Midland Rent Assessment Panel, determining the price payable for the freehold interest in a dwellinghouse known as 167 Kingshurst Road, Northfield, Birmingham, B31 2LL (the appeal property) under section 9(1) of the Leasehold Reform Act 1967.

2. The LVT's decision was dated 27 October 2010. It determined the price payable at £10,878. It also determined the freeholder's reasonable legal costs at £400 plus VAT and disbursements (if applicable) and the reasonable valuation costs at £300 plus VAT (if applicable). On 17 December 2010 an application was made to this Tribunal to appeal against the LVT's decision insofar as it related to the price payable. The basis of the application was that the LVT had been wrong to adopt a two stage valuation, valuing the landlord's reversion on the basis of the section 15 rent in perpetuity. Instead it should have applied a *Haresign* addition, namely an addition to represent the present value of the landlord's reversion to the standing house value after the expiry of the 50 year extension to the term. Also on 17 December 2010 this Tribunal was informed that, subsequent to the LVT's decision, the freehold interest in the appeal property had been transferred from Management Nominees (Reversions) Ltd to Clarise Properties Ltd and the Tribunal was asked to substitute the new owner as the appellant.

3. On 22 February 2011 HH Judge Huskinson, sitting as a judge of this Tribunal, granted permission to appeal and to argue all the points raised in the grounds of appeal. The appeal would proceed by way of a rehearing. Meanwhile, on 4 January 2011 the LVT had issued what it termed a "correction certificate", substituting a deferment rate of 5.75% for the rate of 5.5% which the parties had agreed at the hearing and increasing the freehold price to £10,925. On 18 March 2011 the potential respondent lessee, Mrs Freda Yates, wrote to this Tribunal to say that she wished to take no part in the appeal.

4. On 22 March 2011 the appellant submitted further grounds of appeal relating to the correction certificate and applied for permission to add these grounds to the existing appeal. By the time the hearing commenced this application had not been determined. We said that we were minded to grant permission to extend the appeal to include matters arising from the correction certificate. We added that, in contrast to the matters for which permission to appeal had been granted by Judge Huskinson, we would not hear oral evidence or argument to expand the written material which was before us relating to the correction certificate. Before granting further permission to appeal we wished to be satisfied that Mrs Yates had been informed of the application and the grounds upon which it was made and, if not, we would allow her time to make written submissions on the matter. We were subsequently informed by counsel that the application and grounds had been sent to Mrs Yates on 22 March 2011 and that the appellant's skeleton argument for the hearing had been sent to Mrs Yates on 8 December 2011, six days before the hearing. Accordingly, we grant permission to extend the appeal to include matters arising from the correction certificate.

5. At the hearing Ms Georgia Bedworth of counsel appeared for the appellant. She called expert evidence from Mr John Geraint Evans BSc(Hons), MSt(Cantab), Dip Surv, MCIM, FRSA, FRICS.

Facts

6. From the evidence we find the following facts. The appeal property comprises a two storey semi-detached house built in about 1937 and forming part of a large development of similar houses. It is constructed of brick with a pitched tiled roof. There is a right of way giving vehicular access to a large garden at the rear, potentially allowing a garage to be constructed in the garden. The accommodation comprises an entrance hall, through lounge and kitchen/dining area on the ground floor and two bedrooms and a combined bathroom/wc on the first floor. There is an average sized front garden. The property has a frontage of 6.8m and a site area of approximately 291m^2.

7. Mrs Yates occupies the property under a full repairing and insuring lease for a term of 99 years from 24 June 1937 at a rent of £6.25 per annum. The valuation date is 14 December 2007.

Issues

8. There are two principal issues which arise in this appeal. The first is whether the LVT was entitled to issue a correction certificate adopting a different deferment rate from the one which the parties had agreed. The second is whether, in assessing the price payable, the valuation should be carried out in two stages as determined by the LVT or in three stages (including what has become known as a *Haresign* addition) as suggested by Mr Evans.

The correction certificate

9. In a statement of agreed facts produced at the LVT hearing, the parties agreed the following facts:

> "1.The unexpired term is 28½ years.
>
> 2. The capitalisation rate is 6½%.
>
> 3. The site apportionment is one-third.
>
> 4. The deferment rate is 5½%."

10. In paragraph 9 of its decision the LVT stated that a number of matters had been agreed by the parties. They included the following:

"2. The yield rate to be applied in capitalising the existing ground rent and decapitalising the site value to arrive at the modern ground rent is 6.5%.

3. The deferment rate is 5.5%."

11. In paragraph 10 the LVT recorded that the matters in dispute were the entirety value, whether or not a *Haresign* addition should be adopted and the quantum of reasonable legal and valuation costs. There is no appeal against the LVT's decision so far as it relates to the entirety value (determined at £160,000) and professional costs.

12. In para 20 of its decision the LVT concluded that it was not appropriate in this case to include a *Haresign* addition. The LVT continued:

"21. Accepting the agreed matters noted in paragraph 9 above and then applying the figures of Years Purchase from Parry's Valuation Tables, the Tribunal calculates the price payable as follows:

Term:

Current Ground Rent:	£6.25 per annum	
YP 28½ years @ 6½%:	12.83	£80

Reversion:

Entirety value:	£160,000	
Site apportionment @ 33.33%	£53,333	
Section 15 modern ground rent @ 5½%:	£2,933	
YP in perpetuity deferred 28½ years @ 6½%:	3.681	£10,798
		£10,878

22. Accordingly the Tribunal determines the price payable under section 9 of the 1967 Act for the freehold interest in the subject property at £10,878. In reaching its determination the Tribunal has had regard to the relevant law, their inspection of the subject property, the representations of the parties and the Tribunal's own knowledge and experience as an expert tribunal, but not any special or secret knowledge."

13. The correction certificate read as follows:

"1. I, the chairman of the Leasehold Valuation Tribunal ('LVT'), by this certificate, hereby correct an error arising from an accidental slip or omission in the LVT's 27 October 2010 determination ('Determination') of the price payable for 167 Kingshurst Road, Northfield,, Birmingham B31 2LL as follows:

2. Insert, at para 20A:

'The Tribunal accepts the parties' agreement, at para 9, that the yield rate to be applied in capitalising the existing ground rent is 6.5%. The Tribunal holds that, in calculating the price payable, it shall, irrespective of parties' evidence unless persuasive, apply settled principles derived from an appellate tribunal and the courts. The Tribunal does

not accept the parties' agreement, at para 9, that the yield rate to be applied in decapitalising the site value to arrive at the modern ground rent is 6.5% nor that the deferment rate is 5.5%. The Tribunal finds that 6.5% (decapitalisation) and 5.5% (deferment) both fall short of establishing the contention in support of which they are made. This is because there is clear guidance from the Court of Appeal (*Wilkes v Larcroft Properties Ltd* [1983] 268 EG 903, affirming *Official Custodian of Charities and Others v Goldridge* [1973] 227 EG 1467 (CA)) that, in the absence of persuasive evidence – we have none in the case before us – an "adverse differential" is not appropriate. The parties' "adverse differential" agreement (6.5% decapitalisation 5.5% deferment) is adverse to the tenant Respondent; while *Wilkes* identified a differential adverse to the freeholder the Tribunal holds that non-acceptance of an "adverse differential" applies equally to a tenant and a landlord/freeholder.'

3. Delete the whole of para 21 and substitute the following:

'Accepting, as agreed, 6.5% yield rate for the existing ground rent, rejecting the "adverse differential" (see para 20A above) and applying clear guidance on yield rates for the valuation of the reversion in the West Midlands from Re: *Mansal Securities Ltd & Others* LRA/185/2007 (LT) and *Zuckerman v Trustees Calthorpe Estate* [2009] UKUT 235 (LC), LRA/97/2008, the Tribunal calculates (using Parry's Valuation Tables) the price payable as follows:

Term:		
Ground rent	£6.25 pa	
YP 28½ years @ 6½%	12.83	
		£80
Reversion:		
Entirety value	£160,000	
Site value at 33.33%	£53,333	
Section 15 modern ground rent at 5.75%	£3,067	
YP in perp deferred 28½ years at 5.75%	3.53599	
		£10,845
	Price payable	£10,925

4. At para 22 delete "£10,878", insert "£10,925".

5. Delete the whole of para 24, and substitute the following:

'The Tribunal determines that the price payable by the Respondent tenant for the freehold interest in the subject property is £10,925 and that the Applicant freeholder's reasonable legal costs incurred and payable by the Respondent tenant are £400 plus VAT and disbursements (if applicable) and the reasonable valuation costs are £300 plus VAT (if applicable).'"

14. Ms Bedworth submitted that the LVT had no jurisdiction to issue a correction certificate in these terms. She said that the certificate was purportedly issued under regulation 18(7) of the

Leasehold Valuation Tribunals (Procedure) (England) Regulations 2003. The certificate went far beyond the scope of that rule, which permits an appropriate person to

> "correct any clerical mistakes in a document or any errors arising in it from an accidental slip or omission."

Ms Bedworth said that regulation 18(7) was equivalent to the slip rule in CPR 40.12. She referred to the judgment of the Court of Appeal in *Bristol-Myers Squibb Co v Baker Norton Pharmaceuticals Inc* [2001] EWCA Civ 414 and the decision of this Tribunal in *Chelsea Properties Ltd v Earl Cadogan* LRA/69/2006, 2 October 2007, unreported, to the effect that the slip rule may not be used to alter the substance of a decision and submitted that rule 18(7) should be treated in the same way. In this case the certificate plainly went beyond the correction of a clerical error or an accidental slip. It purported to make a substantive alteration to the deferment rate by substituting a rate which was different from the rate which it originally found and from that agreed by the parties. After the hearing the LVT had changed its mind and sought to substitute a rate of 5.75%. Quite apart from the serious issue of procedural unfairness which arose out of the manner in which the LVT dealt with the matter, the LVT had no power to give effect to that change of mind, whether by correction certificate or otherwise.

15. Ms Bedworth added that the LVT decision was internally inconsistent due to clerical errors and accidental slips that could (and should) have been properly corrected under rule 18(7). At para 9 the LVT wrongly recorded an agreement between the parties that the section 15 rent should be determined by decapitalising the site value at a rate of 6.5%. There was no such agreement. As is plain from the statement of agreed facts, the agreement of a rate of 6.5% related to capitalisation of the existing ground rent. Further, the valuation calculation submitted to the LVT by the appellant's valuer, Mr Plotnek, applied a decapitalisation rate of 5.5% to the site value to arrive at the section 15 rent. This rate of 5.5% was the same as the agreed deferment rate. A decapitalisation rate of 5.5% was the inevitable result of the agreement of the deferment rate of 5.5%. The LVT correctly recorded the agreed deferment rate in paragraph 9 as 5.5%. In its two stage calculation at paragraph 21 of its decision, the LVT correctly applied a 5.5% decapitalisation rate to arrive at the section 15 rent (which was the rate applied by Mr Plotnek). In paragraph 21, the LVT incorrectly recorded 6.5% as the deferment rate, contrary to the agreement recorded in paragraph 9 of its decision. This must have been a typographical error. Despite the figure "6.5%" being typed next to "deferment rate" in the Tribunal's calculation, the multiplier applied by the LVT of 3.681 was a multiplier which applied to a deferment rate of 5.5% (albeit for a period of 50 years not in perpetuity). The multiplier was the same multiplier as had been set out in Mr Plotnek's 3 stage valuation, which applied a deferment rate of 5.5% to the section 15 rent.

16. There were plainly errors or accidental slips in the LVT's decision which required correction, namely the recording of an agreement on the decapitalisation rate which had not been reached; the typing of 6.5% instead of 5.5% as the deferment rate; and the multiplier applied. It was, however, not appropriate to correct these errors by applying a wholly different deferment rate which had not been contended for by the parties or agreed by them.

17. In our judgment the LVT manifestly had no power to alter its decision in the way that it did. The power to alter a decision is that conferred by regulation 18(7) of the 2003 Regulations, and it

is very restricted in scope. It is in essence a slip rule, and the limitations of such a rule were stated in *Bristol-Myers* by Aldous LJ, with whom Laws LJ and Blackburne J agreed, where at paragraph 25 he concluded that the authorities established that

> "the slip rule cannot enable a Court to have second or additional thoughts. Once the order is drawn up any mistake must be corrected by an appellate Court. However it is possible under the slip rule to amend an order to give effect to the intention of the Court."

18. In *Chelsea Properties* the Tribunal (HH Judge Huskinson and N J Rose FRICS) expressed the view at paragraph 13 that a correction certificate was valid provided it:

> "did not purport to alter the ultimate decision by the LVT as to the premium payable."

What the LVT purported to do in the present case was to rewrite major parts of its substantive decision, having had further thoughts about their correctness. It had no power to do this. Moreover it did so without having given notice to the parties and according to them the opportunity to make representations. This was a serious procedural irregularity.

19. We therefore accept Ms Bedworth's submissions on this issue. On the information available to us it appears that the parties had not agreed that an adverse differential should be adopted. But even if they had, it was not appropriate for the LVT to use the slip rule to amend the substance of its decision..

20. We would add that when, as will probably happen in about a year's time, LVTs' powers are transferred to the First-tier Tribunal, it is likely that there will be a wider power to review a decision, as there is in rule 44 of the present Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009; and express provision will be made for giving every party an opportunity to make representations before a decision is altered on review (see rule 44(3)).

The *Haresign* addition, the deferment rate and the valuation effect of the tenant's right to remain in possession: evidence

20. The LVT rejected the evidence of the expert then appearing for the freeholder, Mr Plotnek, to the effect that the value of the freehold interest should be calculated in three stages, the third being the value of the standing house at the termination of the 50-year lease extension (the so-called *Haresign* addition after the decision of the Lands Tribunal (V G Wellings QC) in *Haresign v St John the Baptist's College, Oxford* (1980) 255 EG 711). Instead it adopted a two stage approach. It capitalised the current ground rent for 28½ years at the agreed rate of 6½%. It then purported to capitalise the modern ground rent in perpetuity, deferred 28½ years, at the same rate. In fact, it adopted a YP figure of 3.681, which represents the present value of a rent payable for 50 years, deferred 28½ years at 5½%. Thus, the figure originally determined by the LVT ascribed a value to the freeholder's interest only until the expiry of the extended lease and not beyond.

21. Before us Mr Evans gave evidence to the effect that a three stage approach should be adopted. He quoted an extract from Hague on Leasehold Enfranchisement, Fifth Edition which, so far as is relevant, reads as follows:

> "The purchase price payable by the tenant for the landlord's freehold interest under section 9(1) as amended thus comprises and (subject as mentioned below) in valuations made for the purposes of the Act, can be broken down into the following elements:
>
> (1) the capitalised value of the rent payable under the tenancy from the date of the Notice of Tenant's Claim until the original term date;
>
> (2) the capitalised value of the section 15 rent from the original term date until the expiry of the 50-year extension (due regard being had to the provision for review after the first 25 years of the extension);
>
> (3) the value of the landlord's reversion to the house and premises after the expiry of the 50-year extension, on the basis that Schedule 10 to the Local Government and Housing Act 1989 applies to the tenancy."

22. Mr Evans said that his first experience of leasehold reform work was between 1981 and 1985 when he worked in Cardiff for a practice specialising in such work. At that time it was common practice in South Wales when valuing the eventual reversion to use a substantially higher deferment rate than that used for deferment of the capitalised section15 rent. Commonly it was the practice to apply an additional 1% - 2% to reflect a perceived increase in risk due to the reversion being more distant. Mr Evans observed that it was inherent in any calculation using compound interest (as does the PV calculation used to defer a future sum) that relatively small changes in interest rates might provide what appeared to be disproportionally large changes in final results where such changes in interest rates were considered over long periods of time. For example, at 4¾% the present value of £100,000 over a period of 75 years is £3,079, at 5% £2,580, at 5¼% £2,150, at 5½% £1,800, at 5¾% £1,510 and at 6¾% £745. It became common practice in the early 1980s to ignore the final reversion and to capitalise the section15 rent in perpetuity instead. In practice the difference between the two methods of valuation was marginal.

23. Mr Evans said that the decision of the Lands Tribunal in *Cadogan v Sportelli* [2006] RVR 382 challenged the perceived wisdom that deferment rates on property were different between, say, 25 years and 75 years. Following that decision the separate valuation of the second reversion was no longer marginal. It produced a capital sum substantially different from that resulting from what had become the usual practice of capitalising the section15 rent in perpetuity

24. Mr Evans said that, although the appellant's then surveyor had agreed that the deferment rate should be 5½% at the LVT hearing, he (Mr Evans) considered that that rate should only apply to the first reversion and that the second reversion should be deferred at 5¼%. In support of this approach he referred to the decision of the Lands Tribunal (N J Rose FRICS) in *Zuckerman v Trustees of the Calthorpe Estate* [2010] 1 EGLR 187. He produced information from the Nationwide regional house price index, the Halifax regional house price index the Department of Communities and Local Government regional house price index and the Land Registry. He said that these statistics all supported the conclusion reached in *Zuckerman* that an investor considering long term growth prospects at the appeal property would not be confident that the PCL growth rate

would be achieved in the West Midlands, and that the *Sportelli* generic deferment rate should be increased accordingly.

25. Mr Evans said that, when undertaking two stage valuations of houses in the area covered by the Midland LVT, the accepted practice was for valuers to adopt a deferment rate of 5½%. He believed that this rate had been adopted as a result of the guidance provided by the Tribunal in *Sportelli* (a starting point of 4¾%), *Zuckerman,* and *Mansal Securities Ltd's Appeal* (LRA/185/2007, 24 February 2009, unreported). In *Mansal* the Tribunal increased the *Sportelli* risk premium by 0.25% to compensate for the increased volatility and illiquidity where the reversion was to a site rather than to a standing house. In Mr Evans's opinion, where a three stage approach was adopted, a deferment rate of 5½% should be used for the second stage of the valuation and 5¼% for the third stage. The latter rate, he said, was based on the guidance of *Sportelli* and *Zuckerman* only, since the *Mansal* adjustment of 0.25% should not apply where the reversion was to a standing house.

27. Mr Evans prepared two valuations of the price payable for the freehold interest in the appeal property, assuming a two stage and a three stage approach respectively, as follows:

Two stage approach

Term:		£80
Reversion:		
Entirety Value	£160,000	
Site apportionment @ 33⅓%	£ 53,333	
Section 15 Modern Ground Rent	£ 2,933	
YP perp @ 5½%	£ 53,333	
PV of £1 in 28.5 years @ 5 ½%	0.2174	
		£11,596
		£11,676

Three stage approach

Term:		£80
First Reversion:		
Entirety Value	£160,000	
Site apportionment @ 33⅓%	£ 53,333	
Section15 Modern Ground Rent	£ 2,933	
YP 50 years @ 5½%	16.932	
	£ 49,666	
PV of £1 in 28.5 years @ 5½%	0.2174	£10,798
Second Reversion:		
Standing House Value	£140,000	
PV of £1 in 78.5 years @ 5¼%	.018	£ 2,522
		£ 13,400

28. Mr Evans noted that a three stage valuation produced a figure that was £1,724 higher than a two stage valuation. Since the difference was significant, he considered that the three stage approach should be adopted.

29. Mr Evans said that he agreed with the LVT's assessment of the entirety value at £160,000. That was the value of the property assuming it was modernised, in good condition and fully utilising the potential of the site. In assessing the standing house value (the value of the property in its existing form) he had had regard to the nearly contemporaneous sale of 122 Kingshurst Road at £158,000. That property was larger than the appeal property, having three bedrooms and a small extension. He also bore in mind the sales of numbers. 134, 110 and 120 Kingshurst Road, and concluded that the standing house value of the appeal property at the valuation date was £142,500.

30. Mr Evans reduced this figure to £140,000 to reflect the fact that the tenant is assumed at the end of the tenancy to have the right to remain in possession under an assured tenancy. He emphasised that it was necessary to assume that the tenant would have the *right* to remain in possession, not that he would necessarily continue in possession. Moreover, if the landlord gave notice for an assured tenancy, that tenancy would be at a market rent, which would compensate the landlord for any obligation he would assume to carry out repairs. It was difficult to provide factual evidence of the likelihood of any tenant exercising the right to remain in possession. His decision to deduct £2,500 from the standing house value to reflect that risk was a matter of judgment.

The *Haresign* addition: conclusions

31. From the earliest days of valuations under section 9(1) it appears to have been the practice to adopt the two-stage approach to valuation, not quantifying separately the value of the reversion at the end of the assumed 50-year lease renewal. Thus in *Farr v Millersons Investments Ltd* (1971) 22 P & CR 1055 the Member (R C Walmsley FRICS) said (at 1060) that the "generally recognised approach" was to estimate the section 15 rent and then:

> "To capitalise this section 15 rent as if in perpetuity, deferred for the period of the unexpired term of the existing tenancy; not seeking to quantify any different rent that might become substituted at the expiration of twenty-five years from the original term date, and not quantifying separately the value in reversion at the expiration of fifty years from the original term date."

32. It will be noted that the practice did not assume that the ultimate reversion had no value. On the contrary the fact that the capitalisation of the section 15 rent was in perpetuity rather than to the end of the 50-year renewal meant that a value was attributed to the reversion. The justification for not valuing it separately was evidently that, given the period of deferment and the small amounts of value involved, any difference in the end result would be minimal and would be lost in the other elements of the valuation. In *Haresign v St John's College, Oxford* (1980) 255 EG 711 the landlord's valuer (Mr Barnes) said that in most cases any addition through attributing a specific value to the reversion would be "microscopically small". In that case, however, he had adopted a three-stage approach because it resulted in a gain of £349 to the landlord (in a total valuation of

about £6,000), which, he said, was material (see at 546). The Tribunal (V G Wellings QC) adopted his approach.

33. Thereafter the extra value resulting from a three-stage approach became known as a "*Haresign* addition". The two-stage approach continued as standard practice, and a *Haresign* addition was only made as an exception to it. In two decisions of the Lands Tribunal given on the same day, *Marlodge (Monnow) Ltd's Appeal* (LRA/28/2002) and *Mayfly (Corrib) Ltd's Appeal* (LRA/29/2002) the Member (P H Clarke FRICS) dealt with the issue in this way ((LRA/28/2002, relating to 11 Park Avenue, Cotteridge, Birmingham, at paragraphs 14 and 15: the equivalent paragraphs in the other case are materially the same):

> "14. The lease of 11 Park Avenue had 12 years unexpired at the valuation date. The lease extension assumed under section 9(1)(a) of the 1967 Act is 50 years, giving a reversion in 62 years. At that time the house will be about 160 years old. It is a small terraced house typical of those to be found in the inner areas of Birmingham and in the West Midlands.
>
> 15. The essential question, to my mind, is not whether the subject property will still be standing 62 years after the valuation date, but whether the purchaser in the hypothetical sale envisaged in section 9(1) of the 1967 Act would value the reversion to standing house value? The usual practice is to capitalise the modern ground rent in perpetuity, ignoring both the rent review at the 25th year and the landlord's right to possession at the end of the extended lease. The so-called Haresign addition is an exception to this practice. The circumstances must warrant this exception. I accept that 11 Park Avenue will still be standing at the end of the extended lease but I cannot accept that the hypothetical purchaser would include in his price any additional value for the house in excess of the capitalised ground rent in perpetuity which forms part of a standard enfranchisement valuation under section 9(1). I can accept that a Haresign addition might be included where the house is substantial (as in the *Haresign* decision itself) but not where it is a small terraced house. I am not satisfied that the LVT's decision on this issue is wrong: it seems to follow the evidence which it considered. I am not persuaded by Mr Dixon's evidence that it is wrong."

34. The effect of that decision was to endorse the two-stage approach as the standard valuation practice, with the *Haresign* addition being treated as an exception. It appears that LVTs have followed this guidance and have tended to attach significance to the suggestion that an addition "might be included where the house is substantial" but not, for example, where it is a small terrace house.

35. *Haresign* was most recently the subject of consideration in *Freehold Properties Limited's Appeal* (otherwise referred to as *42 Elmay Road*) [2009] UKUT 172(LC), LRA/150/2008, where the Member (N J Rose FRICS) said this (at paragraph 15):

> "15. In reaching its conclusion that the price payable should be £6,600, the Tribunal in *Haresign* followed Mr Barnes's three stage approach, although it reduced his figures for site value and standing house value. I bear in mind that the Tribunal received no expert evidence on behalf of the lessee in that case. Nevertheless, its approach seems to me to be unimpeachable. The 1967 Act requires the valuer to assume that the freeholder will receive

> a revised modern ground rent for 50 years following the expiry of the existing lease, with a reversion thereafter to the house itself. It appears that in practice valuers have found that the figure which is arrived at by calculating the enfranchisement price in three stages is not materially different from that which results from valuing in two stages, capitalising the section 15 rent in perpetuity. If that were not the case, and the 'three stage value' was significantly higher than the 'two stage value', the former would be the appropriate figure, since no properly advised vendor would accept a lower price than one calculated in accordance with the statutory assumptions."

36. We consider that the time has now come to move away from the two-stage approach as the standard practice in section 9(1) valuations and to apply instead the three-stage approach. As a matter of good valuation practice, where a price has to be determined, every element of value should in general be separately assessed unless there is some good reason not to do so. There is now a much greater likelihood that the ultimate reversion will have a significant value than there was when the two-stage approach became adopted as standard practice 40 years or more ago. There are two reasons for this. The first is that house prices, including the prices of houses that would fall to be valued under section 9(1), have increased substantially in real terms; and the second is the lower deferment rates that are now applied in the light of *Sportelli*. There is, we think, a real danger that applying the two-stage approach as standard will in some cases lead to the exclusion of an element of value that ought to be included in the price. This is particularly so if valuers and LVTs treat as the criterion for the application of a *Haresign* addition whether the house is "substantial" and thus exclude any element of value in the ultimate reversion (other than that included in the capitalisation of the section 15 rent in perpetuity) where the house does not meet this ill-defined criterion. The only relevant question is whether the reversion does have a significant value. In future, therefore, we consider that the appropriate approach will be to capitalise the section 15 rent to the end of the 50-year extension and to assess the value (if any) of the ultimate reversion.

The deferment rate: conclusions

37. The starting point for determining the deferment rate to be applied in this case is the generic rate of 4¾% for houses in Prime Central London (PCL) determined in *Sportelli* (see *Cadogan v Sportelli* [2008] 1WLR 2142 per Carnwath LJ at para 102). We accept Mr Evans's evidence that the prospects of capital growth were lower in the West Midlands than in PCL and that it is appropriate to increase the *Sportelli* rate by 0.5% to reflect this difference in line with the decision in *Zuckerman*. In that case, however, the Tribunal made a further addition of 0.25% because it was "likely to remain economically viable to repair high value properties in PCL for considerably longer than it will for similar sized flats in Kelton Court." The open market value of each of the Kelton Court flats was agreed to be £158,025, which is similar to the agreed value of the appeal property. The respective floor areas of the relevant properties are not available, but in both cases the accommodation includes two bedrooms. Mr Evans did not suggest that there was any reason why the risk of deterioration of the appeal property was less than at Kelton Court and, to be consistent with the decision in *Zuckerman*, we find that the *Sportelli* rate should be increased by a total of ¾% to 5.5%.

38. Mr Evans said that he agreed with the Tribunal's decision in *Mansal* (para 27) to make an addition of 0.25 per cent to the risk premium and thus to the deferment rate in section 9(1) valuations to reflect the greater volatility and illiquidity in a reversion to a ground rent than to a standing house. Although he suggested that the effect of following *Mansal* was that the 50 year lease extension should be deferred at 5.5% and the subsequent reversion at 5.25%, we consider that the latter percentage is not consistent with the decision in *Zuckerman*. In that case the rate of 5.5% was determined under the Leasehold Reform, Housing and Urban Development Act 1993. It thus reflected an assumed reversion to the open market value of a flat, not to site value. Similarly, in this appeal, the third stage of the valuation relates to the value of a standing house, not the site upon which it stands. We therefore find that the deferment rate to be adopted at stage 3 is 5.5%. Mr Evans suggested that, in stage 2, the modern ground rent should be capitalised and deferred at 5.5%. That is the same rate as that used to decapitalise the site value and we accept it. To do otherwise would be to produce an adverse differential. We recognise that, in adopting the same rate for valuing the ground rent in stage 2 and the standing house value in stage 3, we have departed from the approach adopted by the Tribunal in *Mansal*. In *Mansal*, however, the Tribunal's valuations were made in two stages, not three. Moreover, the second stage consisted simply of deferring the site value until the expiry of the existing lease, so that the question of an adverse differential did not arise.

Valuation effect of tenant's right to remain in possession after 50 year lease extension – conclusions

39. When valuing the reversion to a standing house on the expiry of the 50-year lease extension it is necessary to assume that Schedule 10 to the Local Government and Housing Act 1989 applies to the tenancy. Accordingly the tenancy automatically continues until notice is served under para 4 of Schedule 10, when the tenant is entitled to an assured tenancy under the Housing Act 1988 at a market rent. Mr Evans made a deduction of £2,500 (or 1.75 per cent) from his standing house valuation of £142,500 to reflect this provision. He accepted that the freehold interest in a house is significantly less attractive to a purchaser if it is subject to an assured tenancy than if it is vacant. He justified his very modest deduction, however, by emphasising that what is to be assumed is not that the tenant will continue in possession at the end of the 50-year extension, but that the tenant will have the right to remain in possession. It was impossible to know what the view of the tenant would be in 78.5 years' time.

40. It is true that the purchaser of the freehold reversion would have no means of knowing whether vacant possession would be gained at the end of the 50-year lease extension. In our view, however, the fact that there can be no certainty of obtaining vacant possession would have a significant depressing effect on value and a substantially greater effect than that suggested by Mr Evans. In the absence of any comparable evidence to indicate the scale of the appropriate deduction we conclude that a purchaser would assume that the value of the eventual reversion would be £114,000, equivalent to 80% of the full standing house value of £142,500.

41. We therefore calculate the price payable for the freehold interest in the appeal property to be as follows:-

Term: (not appealed) £80

First Reversion

Section 15 modern ground rent	£2,933	
Y.P. 50 years @ 5½%	16.932	
	£49,662	
PV of £1 in 28½ years @ 5½%	0.2175	£10,801

Second reversion

Standing house value	£114,000	
PV of £1 in 78½ years @ 5½%	0.015	£ 1,710
		£12,591
	say	£12,600

42. The appeal is allowed. We determine the price payable for the freehold interest in 167 Kingshurst Road, Northfield at £12,600.

Dated 17 January 2012

George Bartlett QC, President

N J Rose FRICS