

2769



**FIRST-TIER TRIBUNAL  
PROPERTY CHAMBER  
(RESIDENTIAL PROPERTY)**

**Case Reference** : **LON/00AG/OLR/2013/0861**

**Property** : **1, 2, 3, 5, 6, 7, 9, 11, 14, 15, 16, 17, 18,  
20, 22, 23, 24, 26, 27, 28, 29, 30, 32,  
36, 37, 39, 40, 41, 42 and 86  
Sovereign House, 19-23 Fitzroy  
Street, London W1T 4BP**

**Applicant** : **West London & Suburban Property  
Investments Ltd**

**Representative** : **Mr Piers Harrison of counsel,  
instructed by CMS Cameron  
McKenna LLP**

**Respondent** : **The tenants**

**Representative** : **Mr Andrew Hart, solicitor**

**Intermediate landlord** : **Sovereign House Management Co  
Ltd**

**Representative** : **No appearance**

**Type of Application** : **Lease extensions**

**Tribunal Members** : **Judge Adrian Jack, Tribunal  
Member Duncan Jagger MRICS**

**Venue of Deliberations** : **10 Alfred Place, London WC1E 7LR**

**Date of Decision** : **30<sup>th</sup> October 2013**

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**DECISION**

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## **Decisions of the tribunal**

- (1) The Tribunal determines that the sum of £3,000 per flat which the freeholder sought from the tenants in respect of the reduced security for the ground rent payable to it by the intermediate landlord is not payable.
- (2) The amount of the premium payable by each flat is as set out in the schedule hereto.
- (3) Permission to appeal is refused.

## **Procedural**

1. The applicant freeholder by application dated 25<sup>th</sup> June 2013 applied for determination of the terms on which various tenants of flats at Sovereign House were entitled to extend their leases pursuant to Chapter II of Part 1 of the Leasehold Reform, Housing and Urban Development Act 1993. There is an intermediate landlord, which is owned by the tenants. Its reversionary lease is only 3 days longer than the tenants' leases in respect of which an extension was sought.
2. The Tribunal gave directions on 18<sup>th</sup> July 2013. These were almost completely ignored by the parties. Nonetheless the parties agreed (a) the terms of the new leases, (b) (save for the £3,000 per flat still in dispute) the premium to be paid and (c) the division of the premium between the freeholder and the intermediate landlord.
3. The matter was listed for hearing on 29<sup>th</sup> October 2013. On that date, counsel for the freeholder and solicitor for the tenants appeared. No expert reports had been served. The Tribunal indicated that this was wholly unsatisfactory. It refused the parties' application for a long adjournment. Instead directions for the freeholder to serve Mr Orr-Ewing's report by 3 pm that day and Mr Pridell's report by 6 pm. These directions were complied with and both experts gave evidence on 30<sup>th</sup> October 2013.
4. No inspection was requested and none was held.

## **Evidence and submissions**

5. The leases are all in substantially the same form. The term granted is 99 years less three days from Michaelmas 1996. The ground rent of the individual flats is £296 per annum until 28<sup>th</sup> September 2021, then £592 until 28<sup>th</sup> September 2046 and £1,184 per annum until the end of the term.

6. Sovereign House Management Co Ltd is a tenant-owned company. It holds an intermediate lease of 99 years from Michaelmas 1996. The rents payable to the freeholder under this lease are slightly less than the rents receivable from the tenants. In the initial period the difference is between £296 receivable and £267.44 payable, doubling in the subsequent periods.
7. The issue between the parties can be seen from the schedule made by Mr Robert Orr-Ewing in respect of 26 Sovereign House. He first analyses the diminution in the value of the head lessee's interest in conventional terms. He takes a capitalisation rate of rents of 4 per cent per annum (whereas Mr Pridell takes 4.5 per cent). This produces an amount payable to the head lessee of £17,295. Because the head lessee's reversion is only 3 days, it has no commercial value and the experts agreed should be disregarded.
8. As regards the diminution of the freeholder's interest, Mr Orr-Ewing took the unencumbered virtual freehold value of the flat as £464,000. Discounted for 82.60 years at 5 per cent, that gave a current value of £8,246. He then took the value to the freeholder of the reversion after the grant of the extended lease and assessed this as £102, so as to give a total diminution of £8,144 to the freeholder's interest. This calculation was uncontroversial.
9. Mr Orr-Ewing then made a calculation which he said showed the "diminution in the value of the freeholder's interest in the rental income." Here he said that ground rent of £267.44 and the subsequent increases would normally be capitalised at 6 per cent, so as to give a value of the rent under the head lease in respect of this flat of £8,712. However, the risk of the head lessee being unable to pay the rent payable under the head lease needed to be taken into account, so as to increase the rate of capitalisation to 8 per cent. The value of the rent at this rate of capitalisation was £5,671, a difference of £3,041, which he rounded to £3,000.
10. Both experts agreed that this was a novel point, which had never been the subject of argument in any of the very many cases in which both men had acted.
11. Mr Pridell's evidence was that no such allowance for the risk of the head tenant's defaulting should be made. The 4.5 per cent capitalisation rate gave a higher figure than the market rate for ground rents precisely to reflect the fact that the capital sum, suitably invested, would be adequate to pay the rent due under the head lease. There was no valuation principle which could be used to determine what the risk of the head tenant defaulting might be. He pointed out that there was a cushion in that there was a turn which the mesne landlord made on the ground rents and that would be reflected in the capitalised values. In this particular block there were tenants who were not immediately

seeking lease extensions and who were paying ground rents to the intermediate landlord at the higher rate. Such tenants were likely at some point to want a lease extension. When that occurred, the head lessee would have a fresh source of capital. In all these circumstances it would be wrong to make any allowance such as that sought by Mr Orr-Ewing.

12. The Tribunal pointed out that under the law as it currently stands the freeholder would have a right (subject to permission being given by a district judge) to levy a distress on all the flats in the block in the event of the head lessee defaulting on the payment of rent to the freeholder. However, the landlord sought time to make submissions on this issue. Neither of the valuers relied on this and since it makes no difference to the Tribunal's determination, we have ignored the point.

### **Determination**

13. We prefer the evidence of Mr Pridell. It is striking that the point taken by Mr Orr-Ewing could have been taken in any of many thousands of leasehold extension cases where there was an intermediate landlord. Yet both experts, who are among the most experienced valuers in lease extension cases, know of no such cases.
14. The fact that a point is taken for the first time does not mean that it is necessarily a bad point. However, it does mean that close examination of the point needs to be made.
15. The purpose of the 4.5 per cent capitalisation rate for the grounds rents payable to the intermediate landlord is to ensure that it has a sufficient capital sum to pay the rent payable to the freeholder for the remainder of the head lease. It is true of course that the mesne landlord might at some undefined time in the future fall into bad hands and the capital preserved for the payment of the rent to the freeholder dissipated, but that is pure speculation. Moreover, in such an unfortunate scenario, an intermediate landlord still taking ground rents might fail to account to the freeholder for the rents due to it. It is thus unclear that there is any increase, or any measurable increase, in risk to the freeholder from the capitalisation of the ground rents.
16. The capitalisation figures of 6 and 8 per cent taken by Mr Orr-Ewing seem to have no commercial or other empirical basis. As Mr Pridell said, there needs to be some assessment of what the likelihood of the risk of default eventuating might be. Mr Orr-Ewing was unable to do so.
17. For all these reasons we did not allow the £3,000 per flat sought by the freeholder.

18. After informing the parties of our decision, Mr Harrison asked for permission to appeal. In our judgment, this should be a matter for the Upper Tribunal. We have made clear findings of fact and there are no other compelling reasons for granting permission to appeal.

**Name:** Judge Adrian Jack

**Date:** 30<sup>th</sup> October 2013

## **Relevant legislation**

### **Schedule 13 to the 1993 Act**

#### *Diminution in value of landlord's interest*

3(1) The diminution in value of the landlord's interest is the difference between—

- (a) the value of the landlord's interest in the tenant's flat prior to the grant of the new lease; and
- (b) the value of his interest in the flat once the new lease is granted.

(2) Subject to the provisions of this paragraph, the value of any such interest of the landlord as is mentioned in sub-paragraph (1)(a) or (b) 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 (with neither the tenant nor any owner of an intermediate leasehold interest buying or seeking to buy) on the following assumptions—

- (a) on the assumption that the vendor is selling for an estate in fee simple or (as the case may be) such other interest as is held by the landlord, subject to the relevant lease and any intermediate leasehold interests;
- (b) on the assumption that Chapter I and this Chapter confer no right to acquire any interest in any premises containing the tenant's flat or to acquire any new lease;
- (c) on the assumption that any increase in the value of the flat which is attributable to an improvement carried out at his own expense by the tenant or by any predecessor in title is to be disregarded; and
- (d) on the assumption that (subject to paragraph (b)) the vendor is selling with and subject to the rights and burdens with and subject to which the relevant lease has effect or (as the case may be) is to be granted.

(3) In sub-paragraph (2) "the relevant lease" means either the tenant's existing lease or the new lease, depending on whether the valuation is for the purposes of paragraph (a) or paragraph (b) of sub-paragraph (1).

(4) It is hereby declared that the fact that sub-paragraph (2) requires assumptions to be made as to the matters specified in paragraphs (a) to (d) of that sub-paragraph does not preclude the making of assumptions as to other matters where those assumptions are appropriate for determining the amount which at the relevant date any such interest of the landlord as is mentioned in sub-paragraph (1)(a) or (b) might be expected to realise if sold as mentioned in sub-paragraph (2).

(5) In determining any such amount there shall be made such deduction (if any) in respect of any defect in title as on a sale of that interest on the open market might be expected to be allowed between a willing seller and a willing buyer.

(6) The value of any such interest of the landlord as is mentioned in sub-paragraph (1)(a) or (b) shall not be increased by reason of—

- (a) any transaction which—

- (i) is entered into on or after the date of the passing of this Act (otherwise than in pursuance of a contract entered into before that date), and
  - (ii) involves the creation or transfer of an interest superior to (whether or not preceding) any interest held by the tenant; or
- (b) any alteration on or after that date of the terms on which any such superior interest is held.

*Compensation for loss arising out of grant of new lease*

5(1) Where the landlord will suffer any loss or damage to which this paragraph applies, there shall be payable to him such amount as is reasonable to compensate him for that loss or damage.

(2) This paragraph applies to—

(a) any diminution in value of any interest of the landlord in any property other than the tenant's flat which results from the grant to the tenant of the new lease; and

(b) any other loss or damage which results therefrom to the extent that it is referable to the landlord's ownership of any such interest.

(3) Without prejudice to the generality of paragraph (b) of sub-paragraph (2), the kinds of loss falling within that paragraph include loss of development value in relation to the tenant's flat to the extent that it is referable as mentioned in that paragraph.

(4) In sub-paragraph (3) "development value", in relation to the tenant's flat, means any increase in the value of the landlord's interest in the flat which is attributable to the possibility of demolishing, reconstructing, or carrying out substantial works of construction affecting, the flat (whether together with any other premises or otherwise).

Sovereign House, 19/23 Fitzroy Street, W1 - Matrix of Flat Values

Base Savills Index Figure

KF Tone Rate £ psf FHV £ 1,133  
 ID Tone Rate £ psf FHVP £ 1,119

Head of Apartment percentages

Flat No.	P / NP	Floor	Agreed GIA (sq ft)	Valuation Date	Savills Index Figure	KF Floor adjust	KF Aspect/ Position adjust	KF Quantum	KF Adjust for Terrace	KF £ psf	KF FHVP value (£), say	Amount payable to SHM2	Total premium for each flat	Average monthly rent Area London (to rent)	
2		2	393	05/02/2013	207.7	0.00%	0.00%	10.00%	0.00%	£ 1,148	£ 451,250				
3	P	2	403	20/12/2012	205.0	0.00%	0.00%	10.00%	0.00%	£ 1,133	£ 456,500				
5	P	2	373	20/12/2012	205.0	0.00%	0.00%	10.00%	0.00%	£ 1,133	£ 422,500				
6	P	2	609	20/12/2012	205.0	0.00%	0.00%	0.00%	0.00%	£ 1,030	£ 627,250				
7		2	442	23/01/2013	206.3	0.00%	0.00%	10.00%	0.00%	£ 1,140	£ 504,000				
9	P	3	711	20/12/2012	205.0	0.00%	0.00%	0.00%	0.00%	£ 1,030	£ 732,250				
11	P	3	403	20/12/2012	205.0	0.00%	0.00%	10.00%	0.00%	£ 1,133	£ 456,500				
14	P	3	609	20/12/2012	205.0	0.00%	0.00%	0.00%	0.00%	£ 1,030	£ 627,250				
15	P	3	590	20/12/2012	205.0	0.00%	0.00%	10.00%	0.00%	£ 1,133	£ 668,500				
16		3	833	05/02/2013	207.7	0.00%	0.00%	0.00%	0.00%	£ 1,044	£ 869,250				
17	P	4	750	05/02/2013	207.7	1.00%	0.00%	0.00%	0.00%	£ 1,054	£ 790,500				
18		4	397	17/04/2013	210.3	1.00%	0.00%	10.00%	0.00%	£ 1,173	£ 465,500				
20	P	4	369	20/12/2012	205.0	1.00%	0.00%	10.00%	0.00%	£ 1,143	£ 422,000				
22	P	4	607	03/04/2013	210.3	1.00%	0.00%	0.00%	0.00%	£ 1,067	£ 647,750				
23	P	4	442	05/02/2013	207.7	1.00%	0.00%	10.00%	0.00%	£ 1,158	£ 512,000				
24	P	4	833	20/12/2012	205.0	1.00%	0.00%	0.00%	0.00%	£ 1,040	£ 866,500				
26	P	5	397	20/02/2013	207.7	2.00%	0.00%	10.00%	0.00%	£ 1,169	£ 464,000				
27	P	5	403	28/03/2013	209.0	2.00%	0.00%	10.00%	0.00%	£ 1,176	£ 474,000				
28	P	5	372	23/01/2013	206.3	2.00%	0.00%	10.00%	0.00%	£ 1,161	£ 431,750				
29	P	5	373	20/12/2012	205.0	2.00%	0.00%	10.00%	0.00%	£ 1,154	£ 430,250	£ 17,229	£ 24,650	£ 7,421	
32	P	5	833	28/03/2013	209.0	2.00%	0.00%	0.00%	0.00%	£ 1,071	£ 892,250				
36	P	6	369	20/12/2012	205.0	3.00%	0.00%	10.00%	0.00%	£ 1,164	£ 429,500				
37		6	373	20/12/2012	205.0	3.00%	0.00%	10.00%	0.00%	£ 1,164	£ 434,250				
40	P	6	833	23/01/2013	206.3	3.00%	0.00%	0.00%	0.00%	£ 1,068	£ 889,250				
41	P	7	576	20/12/2012	205.0	5.00%	0.00%	10.00%	10.00%	£ 1,288	£ 741,500				
42	P	7	1,188	20/12/2012	205.0	5.00%	0.00%	0.00%	10.00%	£ 1,185	£ 1,407,250				
86		2	369	17/04/2013	210.3	0.00%	0.00%	10.00%	0.00%	£ 1,162	£ 429,000				
27	21														
Totals			14,850								£ 16,542,500				
			550								£ 1,124	£ 612,685			