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Ref: LON/LVT/1756/04

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

**DECISION OF THE LEASEHOLD VALUATION TRIBUNAL ON
APPLICATIONS UNDER SECTION 24 OF THE LEASEHOLD REFORM,
ACT 1967**

Applicant: Millard Investments Limited

Respondents: The Earl Cadogan and Cadogan Estates Ltd

Re: 17 Clabon Mews, London, SW1X 0EG

Date of Tenant's Notice: 23 September 2003

Date of Counter Notice: 8 January 2004

Application date: 19 May 2004

Hearing date: 26 and 27 October and 11 November 2004

Appearances: Mr P Rainey of Counsel
Mr P McAndrews – Solicitor Berger Oliver
Mr R J Orr-Ewing - Knight Frank
Mr R Gutteridge - Knight Frank
For the Applicant

Mr K Munro of Counsel
Miss L Blackwell, Solicitor, Pemberton Greenish
Mr A J McGillavary, W A Ellis
Mr K D Gibbs FRICS, Gerald Eves

Members of the Leasehold Valuation Tribunal:

Mr J S L Goulden JP
Mr D D Banfield FRICS
Mr F W James FRICS

LON/LVT/1756/04

PROPERTY: 17 CLABON MEWS, LONDON, SW1X OEG

BACKGROUND

1. The Tribunal was dealing with an application by the Applicant tenant, Millard Investments Ltd., to determine the price payable to the Respondent Landlords, The Earl Cadogan and Cadogan Estates Ltd., for the freehold of 17 Clabon Mews, London, SW1X OEG (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 14 October 1983 and made between The Honourable Charles Gerald John Cadogan (1) Cadogan Estates Ltd (2) Judith Joseph (3) and Joseph Joseph(4) for a term of 75 years from 24 June 1983 at a rent of £1,000 per annum to 23 June 2004, reviewed at that time to £15,600 per annum and subject to further reviews.

3. The following matters were agreed before the Hearing :-

- (a) The valuation date was 25 September 2003
- (b) The unexpired term of the lease was 54.75 years
- (c) The Gross Internal Area of the subject property was 1950 sq ft or 181.15 sq m.
- (d) £75,000 of value has been added to the property by tenant's improvements since the beginning of the lease.
- (e) The capitalisation rate was 5.5% for the main part of the term.
- (f) The comparable properties to be considered.
- (g) The leasehold value of the house assuming a nominal ground rent is 78% of the freehold value.
- (h) Some adjustment needs to be made to the leasehold value to reflect the onerous ground rent review.

4. Further, at the commencement of the Hearing, the Tribunal was advised that the value of the freehold interest with vacant possession had been agreed at £1,712,500.

5. The issues which required the determination of the Tribunal were as follows:-

- (a) The adjustment to be made for the high ground rent**
- (b) The appropriate deferment rate**

6. The Applicants' expert contended for a (revised) enfranchisement price of £441,750. The Respondent's expert contended for a (revised) enfranchisement price of £552,600. Their respective valuations are attached to this Decision as Appendices B and C.

HEARING

7. The Hearing took place on 26 and 27 October and 11 November 2004.

8. The Applicant, Millard Investments Ltd., was represented by Mr P Rainey of Counsel, Mr P

McAndrews, Solicitor, of Berger Oliver, and Mr R J Orr-Ewing and Mr R G Gutteridge, both of Knight Frank. Mr F Homayoun, the occupier of the subject property and beneficiary of the Applicant Company also attended.

9. The Respondents, The Earl Cadogan and Cadogan Estates Ltd., were represented by Mr K S Munro of Counsel, Miss L Blackwell, Solicitor, of Pemberton Greenish, Mr K D Gibbs FRICS of Gerald Eve and Mr A J McGillivray of WA Ellis. Since, as stated above, the value of the freehold interest with vacant possession had been agreed, Mr McGillivray was not called to give evidence to the Tribunal.

10. The salient points of the evidence are set out under the appropriate heads below.

(a) The adjustment to be made for the high ground rent

11. The ground rent is £1,000 per annum until 24 June 2004. After that date it was due to be reviewed to 1% of the freehold value of the premises. There was discussion between the parties as to what would be an acceptable level of ground rent.

12. Mr Gutteridge, for the Applicant, gave market evidence relating to high ground rents, and referred to the transaction at 18 Clabon Mews, sold in April 2004 for £935,000 on a 73 year lease with a ground rent of £11,640 per annum. This property consisted of 1,245 sq ft equating to £751 per sq ft. He said that adjusting for valuation date and the difference between leasehold and freehold equated to £780 per sq ft. In the opinion of Mr Gutteridge, the high ground rent *"has had no or no significant effect on the sale price"* (of No 18). In his professional opinion however, *"an adjustment of £100,000 would be sufficient"* in respect of No 17 where the ground rent would be £17,125 per annum, based on the agreed freehold value.

13. Mr Orr-Ewing said *"in my view, any formula that leasehold reform valuers may employ should either yield to market evidence or be based on market evidence, rather than tailoring the evidence to fit in with what must be an artificial formula"*. However, he said that, as an alternative, a formulaic approach could be adopted. In this connection, Mr Orr-Ewing referred to the formulaic approach made in **Carl v the Grosvenor Estate (1999)** and **Leslie v the Cadogan Estate (2000)**. In the later case, the Tribunal accepted that a palatable ground rent was 0.1% of the freehold value and Mr Orr-Ewing said *"in broad terms this formula does not seem to represent an unfair method of calculating the adjustment.....in this case, unusually, there is market evidence and in my opinion the market evidence should prevail"*.

14. Mr Orr Ewing contended that 0.1% should be ignored and the balance of the high ground rent should be multiplied by 10 and then deducted from the leasehold value. He confirmed that he had negotiated many settlements using that formula

15. Mr Gibbs considered that the palatable ground rent would be 0.05% of the freehold value, and that this should be ignored, and the balance of the ground rent should be capitalized at 5%.

16. Mr Gibbs relied on the Tribunal decision relating to 36 Cadogan Place, where that Tribunal had *"adopted a tolerance level of 0.055% in order to capitalise the impact on the leasehold value of the excessive ground rent"*.

17. Although Mr Gibbs accepted in cross examination that market rent evidence was preferable, he relied on settlement evidence and said *"even the historic settlement evidence indicates that the 5% I have adopted to 'buy out' the high ground rent is modest in the light of reductions in interest rates"*.

(b) The appropriate deferment rate

18. Mr Orr-Ewing considered that the appropriate percentage was 6% and Mr Gibbs contended for 4.5%.

19. Mr Orr-Ewing said that the appropriate deferment rate had been decided as early as 1989 in the case of **Cadogan v Hows** where a rate of 6% had been determined, based on 109 settlements at that rate. He said *"I see no reason to depart from this rate. The rate has been maintained by the Cadogan Estate and Grosvenor Estate during times of high inflation and low inflation. Until 24 July 2004 it was maintained by the Grosvenor Estate, although its properties are if anything grander and more prestigious than those of the Cadogan Estate. It is to be noted that the Cadogan Estate did not attempt to alter the rate when interest rates were as high as 15%"*.

20. Mr Gibbs, whilst acknowledging the weight of settlement evidence was at a deferment rate of 6%, considered that in view of the long term reduction in interest rates, a lower rate of 4.5% could be justified. In support of this, the Tribunal was referred, inter alia, to the 2002 UK Residential Research Bulletin produced by FPD Savills in which it was stated *"by the end of the year we expect net yields to stand at 2.75%"*, two 2004 Bulletins produced by Knight Frank, referring to a net yield from the Central London residential market of 3.1% (some six months after the valuation date), a 2002 prospectus of the Freehold Income Trust issued by Close Brothers showing yields had fallen from 11.5% in 1995 to 5.6% in April 2002, the Investment Property Database which related to UK Residential Investment to December 2003 and a Lands Tribunal Decision dated 16 April 2004 relating to 57 Shawfield Street SW3 where the Member, Mr NJ Rose FRICS, accepted a deferment rate of 5.25% on a 32.54 year lease. In the Shawfield Street case, Mr Gibbs confirmed that he had considered 4.5% more appropriate (although he confirmed that at the Shawfield Street Hearing at the Lands Tribunal, he had selected 5.0% because of the 21 year review pattern). Mr Gibbs said that his evidence was *"indirect but compelling"*.

INSPECTION

21. The Tribunal made its inspection of the subject property, externally and internally, on 15 November 2004, following the end of the Hearing.

22. The subject property was a mid terrace three storey mews house constructed in 1985, in a sought after wholly residential mews. At the rear was a lightwell at ground floor level and a small roof terrace at first floor level. The accommodation and layout was as set out in the statement of agreed facts.

23. In view of the fact that the value of the freehold with vacant possession had been agreed before evidence was given at the Hearing, it was not considered necessary to inspect comparable properties.

THE TRIBUNAL'S DETERMINATION

(a) The adjustment to be made for the high ground rent

24. The Tribunal accepts that there are various methods for adjusting for high ground rent, and market rent evidence is preferred, where available.

25. However, although Mr Gutteridge provided details of transaction evidence by way of reference to 18 Clabon Mews, which he acknowledged had had little or no effect on the sale price, he went on to contend that in the case of the subject property, a deduction of £100,000 should be made, based on his professional judgement. The Tribunal had some difficulty in reconciling the evidence provided with the deduction suggested. His evidence appeared contradictory.

26. In this case, the Tribunal adopted the formulaic approach espoused by Mr Orr-Ewing and Mr Gibbs. The question for the Tribunal is therefore what would be a "palatable" ground rent.

27. The Tribunal accepts Mr Orr-Ewing's opinion that the palatable ground rent should be no more than 0.1% on the specific facts of this case, but would stress that this percentage is not intended to be taken as a guide in future cases.

28. Mr Orr-Ewing's contention that the balance of the ground rent reserved should be multiplied by 10 is rejected as being somewhat simplistic. It is thought that a purchaser of this type and value of property would be financially aware and suitably advised. The Tribunal therefore adopts a capitalization approach.

29. The Tribunal has not been persuaded by Mr Gibbs' arguments and considers the capitalization rate should be the same as that used for the term, ie 5.5%

(b) The appropriate deferment rate

30. The Tribunal has considered with care the arguments and evidence provided by the expert witnesses, and is conscious that yield, and in particular, deferment yield, is a contentious issue. The Tribunal is not only aware of the Lands Tribunal Decision relating to 57 Shawfield Street referred to in this case, but also the other Leasehold Valuation Tribunal Decisions which have been appealed to the Lands Tribunal.

31. Every Leasehold Valuation Tribunal must, of course, reach its decision on the evidence presented to it, supplemented by its own knowledge and experience. 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, a fact which was acknowledged by the Lands Tribunal in its Decision on 57 Shawfield Street.

32. Reference was made by Mr Gibbs to the Freehold Income Trust. This is a unit trust whose investment criteria is to "*concentrate on acquiring freeholds where leases have a long term remaining*". It is apparent that the Trust invests in properties outside London with low ground rents which they purchase at between 10 and 12 YP. Additional income is primarily generated

from lease extensions, insurance, granting consent for alterations etc. Where freeholds are sold for capital gain, the proceeds are re-invested to maintain the income stream.

33. Mr Gibbs was unable to produce a more up to date prospectus than that dated April 2002 where the figures relate in the main to 2001. Furthermore, no projected figures were presented although target yields, as stated by the Trust are set at 5% from July 2002. It is clear that since its inception in 1993, the yield on offer price of the fund has depreciated to 5.6%. However, this yield (ie the gross income expressed as a percentage of the offer price of the unit) is the yield to the investor in the fund, net of all management and other ongoing annual charges involved in a fund of this nature. In the opinion of this Tribunal, this indicates a real yield or income of a few percentage points higher than 5.6%. In any event, the prospectus is aimed at the investor in the fund and, in the Tribunal does not consider that it is evidence of open market transactions which the Act requires the Tribunal to consider.

34. With regard to FPD Savills' Index of Prime Central London Gross and Net Yields, Mr Gibbs provided a copy of Table 3, which showed that gross and net yields for PCL houses in September 2003 were 4.6% and 2.4% respectively. It also showed that yields had fallen from previous highs of 9.5% and 6.2% in December 1992 and 8.1% and 5.1% in December 1998. This Table forms part of FPD Savills' Residential Data, but no background notes were provided, and no explanation was given as to 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 view of the Tribunal, 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

35. In respect of the Investment Property Database (IPD), Mr Gibbs 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. The Index reflects the yield from rents of assured shorthold tenancies against vacant possession values, and therefore is also portfolio, rather than transaction, based. In the view of the Tribunal, it does not necessarily reflect the yield which a purchaser would be prepared to accept in an open market transaction at the valuation date.

36. As a separate issue, the Tribunal cannot relate projected long term yield from rental investments generally to the growth potential of the subject property. Although Mr Gibbs had provided considerable settlement evidence, that was no evidence of yield rates agreed at the rate he now contended.

37. In Mr Rainey's closing submissions he said *"the length of Mr Gibbs' proof in respect of this issue should not disguise a distinct lack of evidence"*. The Tribunal has sympathy with Mr

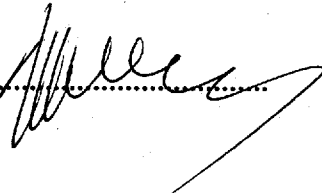
Rainey's view that Mr Gibbs' suggested departure from 6% to 4.5% was unsustainable.

38. It is noted that Mr Rainey, on behalf of the Applicant, stated "*it is no part of the tenant's case that yields are immovable or immutable or in a solar system of their own*". However, there has been insufficient evidence provided to this Tribunal in this case to support a reduction from the present rate. The Tribunal therefore determines a deferment rate for the reversion of 6%.

PREMIUM

39. The Tribunal determines the enfranchisement price for the freehold interest in the subject property at £492,425 and its valuation is attached as Appendix A.

CHAIRMAN.....



DATE.....

15.12.04

Leasehold Reform Act 1967 as amended

Section 9(1C) Valuation

Appendix A17 CLABON MEWS, LONDON, SW1X 0EGAgreed matters

Valuation date	25th September 2003
Unexpired term	54.75 years
Value of f'hold with v.p.	£1,712,500
Capitalisation rate	5.50%
Relativity	78%

Determined by Tribunal

Allowance for high ground rent	Excess over 0.1% capitalised @5.5% and deferred
Deferment rate	6%

Value of lessees interest ex marriage

78% of F'hold VP of	£1,712,500	1,335,750	
Less allowance for excess GR			
GR under lease at 1%		17,125	
Less palatable rent at .1%		<u>1,712</u>	
Excess rent		15,413	
YP 54 yrs def .75 yrs @ 5.5%/6%		<u>16.437038</u>	
Allowance for excess GR			<u>253,344</u>
Value of leasehold excluding marriage			<u>1,082,406</u>

Value of freehold excluding marriageTerm

Current ground rent			1,000	
YP 0.75yrs @	5.5%		<u>0.71093</u>	711
Ground rent from 24/6/04			17,125	
YP54yrs @	5.50%	17.17		
Deferred 0.75 yrs @	6.00%	0.9572	<u>16.435124</u>	281,451

Reversion

Freehold VP			1,712,500	
Deferred 54.75 yrs @	6%		<u>0.04239</u>	<u>72,593</u>
				354,755

Marriage Value

Freehold VP			1,712,500	
Less freeholder's interest ex marriage		354,755		
Lessee's interest ex marriage		<u>1,082,406</u>		
			<u>1,437,161</u>	
Marriage Value			275,339	
To lessor @		50%		<u>137,670</u>

Enfranchisement price£492,425

17 CLABON MEWSFormulaic approach

Freehold value (improved)			£1,750,000
Freehold value (unimproved)			£1,712,500
54.75 year lease based on relativity of		78%	£1,335,750
"Palatable" ground rent @	0.10%	of FH value	£1,713
Multiply "excess" rent of	£15,413	x	10
Adjusted leasehold value			£154,125
			£1,181,625

FREEHOLDERS INTEREST

Capitalisation of ground rent

Ground rent	£1,000			
Y.P. @ 5.5%	0.75 yrs	x	0.716	£716
Ground rent on review	£17,125			
Y.P. @ 5.5%	54 yrs	x	17.172	
P.V. £1 @ 6% in	0.75 yrs	x	0.9572	£281,484

Freehold value	£1,712,500		
P.V. of £1 for	54.75 yrs @ 6%	x	0.0411
			£70,384
			<u>£352,584</u>

Total freeholder's interest

MARRIAGE VALUE

Freehold value less sum of leasehold value and freeholder's interest

Freehold Value	£1,712,500
Less	
Leasehold Value	£1,181,625
Freeholders Interest	£352,584

Marriage Value	<u>£178,291</u>
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50% to freeholder	<u>£89,146</u>
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So	Freehold Premium	<u>£441,729</u>
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Say:	<u>£ 441,750</u>
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GeraldEve

APPENDIX C

KDG A

CADOGAN ESTATES LIMITED

LEASEHOLD REFORM ACT 1967 (AS AMENDED)

Property: 17 Clabon Mews, London SW1

Date of Claim: September 25, 2003

Unexpired term of lease: 54.75 years

VALUATION IN ACCORDANCE WITH SECTION 9 (1C) OF THE LEASEHOLD REFORM ACT 1967 (AS AMENDED)

	£	£	£
Value of Lessor's Interest excluding marriage value			
For remainder of term -			
Rent currently payable	1,000		
Capitalised for 0.75 years @ 3.00%	<u>0.728</u>	728	
Ground rent payable on June 24, 2004 at review to			
1.00% of FVP reviewable every 21 years	17,125		
Capitalised for 54.00 years @ 5.50%	17.17		
Deferred 0.75 years @ 5.50%	<u>0.961</u>	<u>16.50</u>	282,568
For reversion to -			
Value of freehold in possession	1,712,500		
Deferred 54.75 years @ 4.50%	<u>0.0898</u>	<u>153,820</u>	437,118
Add Lessor's share of marriage value			
Value of freehold in possession		1,712,500	
<u>Less</u>			
Value of lessor's interest exclusive of marriage value	437,118		
Value of lessee's interest exclusive of marriage value	<u>1,044,428</u>	<u>1,481,548</u>	
Gain on marriage		230,954	
Attributed to lessor at 50.0%			<u>115,477</u>
Enfranchisement price			552,595
Floor area (sq ft) 1,950		say	<u>£ 552,600</u>
FVP per sq ft £878			

GeraldEve
Chartered Surveyors
& Property Consultants
KDG/CNCP/A11870