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The law as stated during this webinar is as at 10^{th} March 2015



Nicholas Kissen Leasehold Advisory Service 10 March 2015

A reminder of the key legislation

 Leasehold Reform Housing and Urban Development Act 1993

Page 3

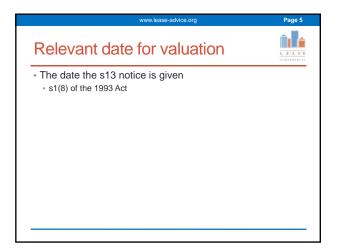
Page 4

- Part I Chapter 1
- Section 1(1)(b) and Schedule 6

A reminder of the key legislation

Commonhold and Leasehold Reform Act 2002 changes
 * 80 years or more remaining on lease

Marriage value nil
Schedule 6,para.4(2A) of the 1993 Act



Which issues we shall be covering

- Capitalisation rate
- Deferment rate Relativity
- Treatment of development value

www.lease-advice.ord Components of premium - Schedule



Page 6 ÎL

6 of 1993 Act • Value of freeholder's interest

- Paragraph 3
- Freeholder's share of marriage value Paragraph 4
- Any compensation payable Paragraph 5

Page 8 www.lease-advice.org ÎL The landlord's interest • Term and reversion method of valuation · Capitalising the value of the ground rent · Valuing the reversion

Valuation of landlord's interest



 The amount which at the valuation date that interest might be expected to realise if sold on the open market by a willing seller.....

Valuation of landlord's interest



 With neither the nominee purchaser or any tenant nor any owner of an intermediate interest buying or seeking to buy and on certain assumptions

Page 14 Assumptions Sale of estate in fee simple Subject to relevant leases and Any intermediate lease(s) or Other leasehold interest(s) The 1993 Act confers no right to a lease extension or to take part in collective enfranchisement Improvements disregard Rights and burdens

Capitalised ground rent

- Application of yield rates
- Term should usually be considered separately from deferment rate for reversion

Nicholson v Goff [2007] 1 EGLR 83



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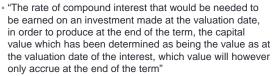
- Lands Tribunal decision of 8 January 2007
- Development outside Birmingham City Centre
- 11 flats above retail units
- Lease of three bed flat
 - Granted in 1931
 - 99 year term
- Fixed rent of £50 pa
- Relevant valuation date
- 8 April 2005

Nicholson v Goff [2007] 1 EGLR 83 • Factors relevant to the capitalisation rate • Length of lease term • Security of recovery • Size of ground rent

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- Whether there was provision for rent review
- The nature of any such rent review

Reversion - deferment rate



• Arbib v Earl Cadogan [2005] 3 EGLR 139 para 87

Earl Cadogan v Sportelli [2007]1 EGLR 153

- Court of Appeal judgment of 25 October 2007
- Properties within SW1, SW3, SW7 and W1 postcodes
 Prime Central London

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Page 1

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- Conjoined appeals
- Mixture of enfranchisement and extension claims
- Issue of deferment rate applicable when valuing freehold interest with vacant possession

Earl Cadogan v Sportelli [2007]1 EGLR 153

- Lands Tribunal applied general deferment rate of 4.75% for houses and 5% for flats
- Court of Appeal decided it was appropriate for LT to lay down guidelines as to deferment rate applicable in future cases
- In future cases involving property outside PCL the deferment rate adopted by LT would be the starting point, although evidence might be called to show that a different rate should be applied

Components of Sportelli rate

- Risk-free rate (RFR)
- Real growth rate (RGR)
- Risk premium (RP)

Risk-free rate



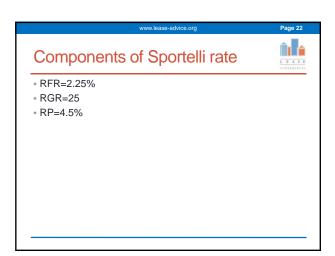
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- The return demanded by investors for holding an asset with no risk, often proxied by the return on a government security held to redemption
- Why 2.25% chosen?
- Average index-linked yields on a five year rolling basis over the last decade suggested that a more stable market based risk-free rate would be in the range 2.0 per cent -2.5 per cent

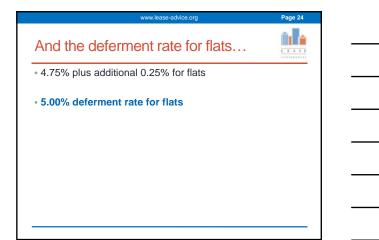
Page 20 Real growth rate 2% adopted as assumed growth rate Note fluctuation in house prices Note substantial difference over a long period that can arise from different rates

www.lease-advice.org Page 21 Risk premium The additional return required by investors to compensate for the risk of not receiving a guaranteed return Volatility

- Iliquidity
- Deterioration
- Obsolescence
- LT considered 4.5% was appropriate rate



| | www.lease-advice.org | Page 23 |
|--------------------------------|----------------------|-----------|
| What does the | e 5% deferment rate | ÎL |
| comprise? | | L E A S E |
| RFR-RGR+RP | | |
| • 2.25%-2%+4.5% | | |
| 4.75% deferment | rate for houses | |
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The Sportelli rate



- Applies where unexpired terms of 20 years or more
- With leases of less than 20 years deferment rate would need to take account of property cycle at valuation date
- Applying universal deferment rate irrespective of location
 Court of Appeal leaving open the possibility of further
- evidence in areas outside PCL
 Sportelli still the starting point

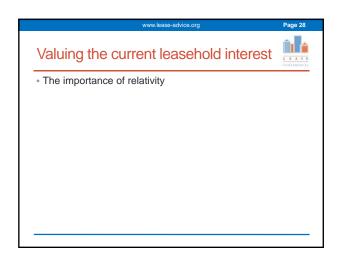
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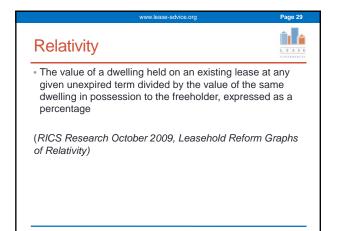
Marriage value



- Recognises those participating can grant themselves new long leases at peppercorn ground rent
- Excess value bought about by merger on interests
- Only payable in respect of participating lessees and remain so until binding contract entered into
 Hope value?
- 50% marriage value paid
- Only paid where leases have less than 80 years term unexpired when s13 notice served

www.lease-advice.org Page 27 Marriage value Image: state of the st





Relativity



- Value freehold vacant possession value
- Work out what proportion of that value remaining lease should be
- Percentage/proportion = relativity

Relativity



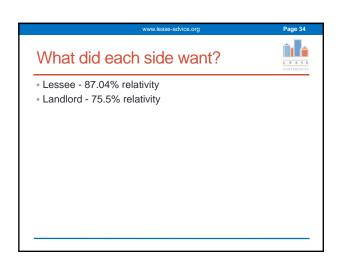
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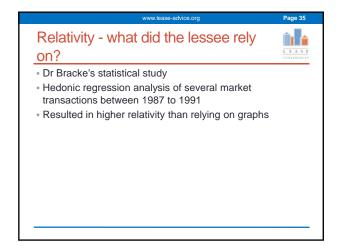
- Actual transactions
- Graphs based on tribunal decisions and settlement evidence
- Doing the best you can

How to approach relativity?

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| Relativity - what did the les on? | | A S E |
| Graphs published by the RICS | | |
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The lessee's argument



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L E A S E

 Graphs prepared by others much less reliable than Dr Bracke's study

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Landlord produced no valuation evidence based on comparables

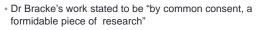
The landlord's argument

 Dr Bracke's study merely evidence of state of market in 1987 to 1991

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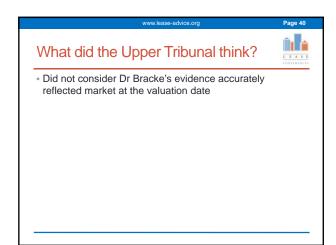
 No grounds to believe study reflected present state of the market

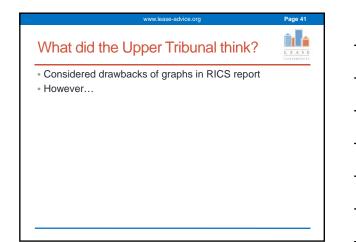
What did the Upper Tribunal think?



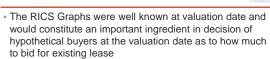
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- Point estimates of relativity for certain periods of unexpired lease were unrealistically high
- Tribunal wary of graph which appeared to be flat between 50 and 80 years

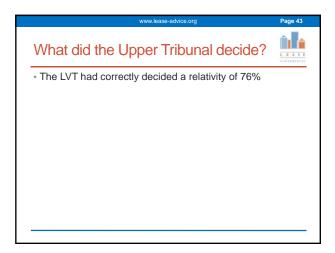


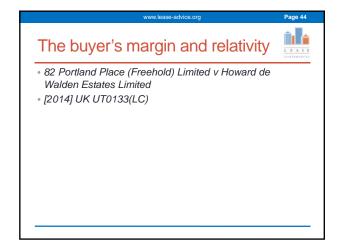


What did the Upper Tribunal think?



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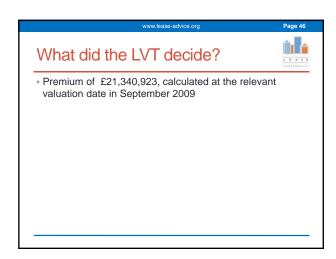


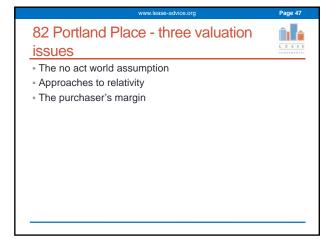


The facts

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- 1920s mansion block in Marylebone
- 25 flats on basement, ground and eight upper floors
- Harley Street Conservation Area
- 14 had unexpired terms of 11.82 years
- 11 flats had extended leases expiring in 2111
- Owners of two flats not executed participation agreement or given Section 13 notice





The no act world assumption

L E A S E

- McHale v Earl Cadogan
 [2010] EWCA Civ 1471
- \circ Judgment of the Court of Appeal dated 21^{st} December 2010
- In calculating marriage value is the leasehold interest valued with a no Act world assumption?
- Parties bound by judgment in case that was settled after Supreme Court granted leave to appeal

Approaches to relativity



 Real world relativity could help in valuing existing leases even though for purposes of working out marriage value leases had to be valued in the no Act world on assumption 1993 Act did not apply

Approaches to relativity



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Ascertaining relativity in no Act world complicated by

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Passage of time

· Limited availability of reliable valuation data

Approaches to relativity

 Evidence available to establish relativity of short leases to freehold vacant possession value of same flat in current conditions

Approaches to relativity



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 One of valuation methods for short leases in no Act world was to undertake adjustment to real world relativity established by evidence of market sales of short leases

In a nutshell.....

a) Establish real world relativity at relevant lease length

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b) Adjust to reflect hypothetical no Act world

What did Upper Tribunal decide?

 Parties agreed that in real world leases with 11.82 years left and enjoying 1993 Act rights worth 41.25% of FHVP of same flat

Discount to reflect no Act world

The appropriate relativity



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- Look at available graphs in PCL
- Average of figures produced by graphs was 33.5%
- Reinforced parties' experts evidence as to proper no Act world reduction

The appropriate relativity



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- Upper Tribunal decided appropriate discount for 93 Act rights where 11.82 years unexpired was 20%
- Therefore appropriate no Act relativity was 33% for calculating marriage value
 41.25% x 80%
- Tribunal restated the Nailrile orthodoxy

The Nailrile orthodoxy



 One must do the best one can with real world evidence of relativity allowing for the benefit of the Act and with regard to the various graphs of no-Act world relativity

The purchaser's margin



 Difference in value between amount that a dealer or an investor (the purchaser) would pay on reversion for the freehold of the building with vacant possession of the short leasehold flats and the aggregate value of those flats if sold individually to an end user

The purchaser's margin



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 Should the margin be deducted from the aggregate of all freehold vacant possession (FHVP) values?

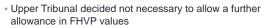
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Bulk discount

 Reducing FHVP values by deducting professional costs and disbursements from those values

Reflecting likely costs which the nominee purchaser might incur on re-sales

The purchaser's margin



"There is no statutory requirement to assume a further sale upon expiry of the short leasehold interests and we see no justification for the assumption of such a sale. The only sale required to be assumed is the valuation date"

Development potential



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- Padmore v Official Custodian for Charities
- [2012] UKUT 0211(LC)
- Decision of the Upper Tribunal (Lands Chamber) dated 31 December 2013

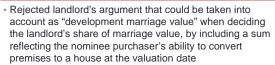
www.lease-advice.org Page 62 Padmore - the facts Image: Comparison of the facts • Semi-detached property in Barnet EN4 • Two maisonettes on separate leases • Each had 61 years unexpired • Both owned by Miss Padmore

The issue To what extent the prospect of reconversion to a house could be taken into account when decided the price for collective enfranchisement

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What did the LVT decide?



Applied Themeline Limited v Vowden Investments Limited
 [2011] UKUT 168 (LC)

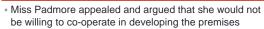
What did the LVT decide?

 Chance of reconversion could be taken into account as "development hope value" when valuing the freehold interest

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- Assumption that hypothetical buyer of freehold interest would pay premium because of prospect/hope of being able to reach agreement with owner of leasehold interests to acquire those interests to enable reconversion to happen
- Decided price payable on that assumption was £150k
 Agreed between parties

What did the LVT decide?



 Cross-appeal by landlord who argued Themeline wrongly decided and including development marriage value would produce price of £194k

Decision of the Upper Tribunal

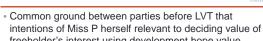


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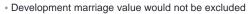
- Not open to Miss Padmore to challenge LVT on ground that gave insufficient weight to her personal views
- Credible that buyer prepared to pay premium to reflect development value as circumstances and intentions of Miss P might change

Decision of the Upper Tribunal



- freeholder's interest using development hope value
 This assumption correct as valuing freeholder's interest
- Parties taken to have had Miss P's personal intentions in mind when reached agreement on appropriate discount to use in calculating development hope value

Decision of the Upper Tribunal



- No legitimate portion of value should be left out when deciding price
- Development value would be released immediately when Miss P able to marry freehold and her existing leasehold interests
- So premium would be £194,000

Upcoming LEASE training

Classroom training 25 March 2015 – London 1 April 2015 – Manchester

Right to Manage

The Right to Manage is a very popular option for leaseholders who want to take over the management of their building. This right contains pitfalls for the unwary, which can cause substantial problems. This fuil day training course will detail these problems, and provide you with the knowledge to take your clients through these procedures with confidence

Webinar

19 March 2015

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Basic introduction to park homes legislation The Mobile Homes Act 2013 aims to improve standards in the industry and give greater protection to mobile home residents. This webinar will take you through the main changes brought about by the legislation. It will touch on the buying and selling process, the new licensing powers that Local Authorities now have, site rule making process and pitch fee reviews

