UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007
AN APPEAL FROM A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR WALES

LEASEHOLD ENFRANCHISEMENT – DEFERMENT RATE – challenge to the risk-free rate and the decision in* Sportelli *- quality of evidence

BETWEEN:

LLANGEWYDD COURT GROUND RENT ESTATE

Appellant

-and-

(1) JAMES ANTHONY RALPH
(2) VICTORIA RALPH

Respondents

Re: 26 Barnes Avenue,
Llangewydd Court,
Bridgend,
CF31 4TT

Upper Tribunal Judge Elizabeth Cooke and Diane Martin MRICS FAAV
Royal Courts of Justice
21 September 2021

Mr Hopkin Joseph for the appellant

The following cases are referred to in this decision:

Re Clarise Properties Limited's Appeal [2012] UKUT 0334 (LC)
Earl Cadogan v Sportelli [2007] EWCA Civ 1042
Earl Cadogan and Cadogan Estates Limited v Sportelli [2007] 1 EGLR 153
Hong Xue v Cherry [2015] UKUT 651 (LC)
R (on the application of Wellcome Trust Limited) v Upper Tribunal (Administrative Appeals Chamber) [2013] EWHC 2803 (Admin)
Sinclair Gardens Investments (Kensington) Limited: Re:7, Grange Crescent [2014] UKUT 79 (LC)
Zuckerman v Trustees of the Calthorpe Estate [2009] UKUT 235 (LC)

Introduction

1. This appeal is about the deferment rate to be used when determining the premium payable on the purchase of the freehold by a tenant under a long lease, pursuant to the leasehold reform legislation. The rate was the subject of a decision of the Tribunal in 2007, approved by the Court of Appeal, and that decision has the status of a "guidance case" – a status which we explain below - and was followed by the Leasehold Valuation Tribunal for Wales ("the LVT") when it determined the premium payable by the respondent tenant, who has chosen not to take part in the appeal.

2. The Tribunal directed that the appeal would be a review of the decision of the LVT dated 6 January 2021; we heard the appeal at the Royal Courts of Justice on 21 September 2021. The appellant was represented by Mr Hopkin Joseph MRICS, and we are grateful to him.

3. The appeal fails, not because the landlord's point could not have succeeded but because the evidence presented by the landlord was not sufficiently persuasive to displace the authority of the guidance case, for the reasons we now explain.

The legal background

4. Part 1 of the Leasehold Reform Act 1967 confers on tenants of qualifying leasehold houses a right to acquire the freehold interest of the house and premises. Section 9 of the Act sets out the basis for calculating the price payable and section 21 sets out the jurisdiction of the First-tier and Upper Tribunals to determine the price in default of agreement between the parties.

5. The price payable for the freehold, in this case to be assessed under section 9(1) of the Act, is assessed under the conventional valuation practice, preferred by this Tribunal in *Re Clarise Properties Limited's Appeal* [2012] UKUT 0334 (LC), as the aggregate of three elements of value. The first is the value of the existing ground rent receivable for the remainder of the original term ("the term"). The second is the present value of the modern ground rent ("s.15 rent") that would have been receivable for the extended lease period of 50 years from the end of the original term had the tenant chosen to extend the lease ("the first reversion"). The third is the present value of the freeholder's reversion to a house with vacant possession at the expiry of the extended lease ("the freehold reversion"). A discount may be made from the value of the house to allow for the risk that when the long lease comes to an end the tenant might stay on so that an assured tenancy would arise under Schedule 10 of the Local Government and Housing Act 1989 ("Schedule 10 rights").

The deferment rate and the decision in Sportelli

6. This appeal concerns the deferment rate used to calculate two of those three elements, namely the sums payable for the first reversion and for the freehold reversion. Both represent elements of value to which the freeholder would not be entitled (absent the enfranchisement)

until years later, and therefore a deferment rate is applied to the current value to reflect that delayed receipt.[1]

7. In *Earl Cadogan and Cadogan Estates Limited v Sportelli* [2007] 1 EGLR 153 the Lands Tribunal decided five appeals. It set a deferment rate of 4.75% for houses and 5% for flats, after an 11-day trial and having heard from a stellar array of eight expert witnesses in the fields of valuation, finance and economics. We refer to this decision (rather than to the decision of the Court of Appeal that affirmed it) as "*Sportelli"*.

8. The deferment rate set by *Sportelli* was made up of three ingredients: a 2.25% rate of return for risk-free investment (based on evidence in particular of the returns on index linked gilt-edged investments), to which was added a 4.5% "risk premium" in recognition of the expectation the landlord would in fact be accepting some risk by investing in property. From that 6.75% was subtracted 2% to reflect long term growth in property values, giving a rate of 4.75%. A further 0.25% was added for flats because the management responsibilities associated with them make flats a more expensive or risky investment. It will not escape anyone's notice that the risk free rate looks high in the light of today's interest rates.

9. In determining the deferment rate the Tribunal in *Sportelli* did not create a legal precedent, because neither the deferment rate nor the method by which it is calculated is a proposition of law. Nevertheless, the Tribunal said at paragraph 121:

> "It is obviously undesirable and, indeed, it would be impossible, for the sort of financial and valuation evidence that we have heard to be called and considered in every enfranchisement case. It is, in our judgment, unnecessary that it should be, because LVTs and this tribunal are entitled to rely upon their own expertise, guided by this decision. The prospect of varying conclusions on the deferment rate in different cases reached on evidence that was less comprehensive than that before us can therefore be avoided by LVTs adopting the practice of following the guidance of this decision **unless compelling evidence to the contrary is adduced**. This is justified because, as we have explained above, the deferment rate is unlikely to vary according to factors particular to the individual case. Some factors, including, in particular, the prospect of long-term growth, will not vary from case to case, while other factors, such as location and obsolescence, will already be reflected in the vacant possession value." (emphasis added)

[1] For readers unfamiliar with valuation theory: the deferment rate is like a rate of compound interest. If the freehold is worth, say, £250,000 now but is not available for 50 years, the deferment rate is the rate of compound interest which, when applied to a sum paid now, would yield £250,000 after 50 years. So the sum payable now can be calculated by applying the deferment rate to the known value of £250,000, in a discounting process which is the reverse of applying compound interest to an investment made now to find out what it will yield in 50 years' time. The lower the deferment rate, the higher the sum payable now. Obviously a sum that is arrived at by applying a deferment rate to the current value of the house makes no allowance for the fact that property grows in value, so that the house will be worth more than its current value in 50 years' time. The deferment rate has to be adjusted to allow for this, as we shall explain. A deferment rate is also required to value the first reversion, because the s.15 rent (which is calculated by de-capitalising the value of the site) is not payable until the original term date. Since *Re Clarise* the deferment rate used to value the freehold reversion has generally been used also in valuing the first reversion.

10. The Court of Appeal ([2007] EWCA Civ 1042) approved the decision in *Sportelli* as well as what the Tribunal had said about its status; they likened it to a guideline case in the context of personal injury damages and the "country guidance cases" that provide authoritative assessments of conditions in various countries for the use of the courts and tribunals in asylum decisions.

11. However, the Court of Appeal took pains to point out that *Sportelli* was a decision about a property in "prime central London" (often abbreviated to "PCL", and charmingly referred to as "Sportelli-land" in *Hong Xue v Cherry* [2015] UKUT 651 (LC)). It went on at paragraph 102:

> "The issues within the PCL were fully examined in a fully contested dispute between directly interested parties. The same cannot be said in respect of other areas. The judgement that the same deferment rate should apply outside the PCL area was made, and could only be made, on the evidence then available. That must leave the way open to the possibility of further evidence being called by other parties in other cases directly concerned with different areas."

12. In *R (on the application of Wellcome Trust Limited) v Upper Tribunal (Administrative Appeals Chamber*[2]*)* [2013] EWHC 2803 (Admin) Ouseley J refused permission to seek judicial review of a decision not to admit evidence that challenged the correctness of *Sportelli*, on the basis that it did not amount to the "compelling justification" that could support such a challenge. However, at paragraph 44 he said "A more relaxed test may be appropriate if the question is whether there is some specific feature in a particular case which is said make to the guideline inapplicable, although otherwise correct."

13. That is what happened in *Zuckerman v Calthorpe Estates Trustees* [2009] UKUT 235 (PC) where the Tribunal heard evidence about considerations that applied specifically to flats, and about the growth rates of property outside London. Of its various conclusions, the one that is relevant to this appeal is the addition of 0.5% to the deferment rate, to allow for poorer long term property growth in the West Midlands. *Zuckerman* is not a guidance case; but the Tribunal noted in *Sinclair Gardens Investments (Kensington) Limited: Re: 7, Grange Crescent* [2014] UKUT 79 (LC) that it had been treated in *Clarise* "as providing evidence in its own right relevant to the deferment rate appropriate to modest flats and houses in the West Midlands" (paragraph 78), and took the same approach in that case (paragraph 91). In practice it has been widely adopted in other regions, as we shall see in the present appeal.

14. The time is now long past when it could plausibly be claimed that there is evidence that the deferment rate in *Sportelli* was wrong at the time when, and in the circumstances in which, it was made. However, a challenge to the rate might succeed in two circumstances. First, where evidence relating to the specific property or its locality shows that a different rate is required in a particular case. Second, it would be possible to prove that the *Sportelli* deferment rate is wrong, for all properties and localities, if there is "compelling evidence"

[2] The case is wrongly named; judicial review was sought of a decision of the Lands Chamber of the Upper Tribunal.

(see the emphasised text at paragraph [9] above) that circumstances have changed so that the decision itself is no longer correct.

15. In the present appeal the challenge is not based on the property itself or its locality; rather, the appellant argues that the risk-free rate is no longer correct on the basis of national economic factors and in particular the low level of interest rates. The appellant also argues that a *Zuckerman* addition to the deferment rate, for reduced growth outside PCL, is no longer appropriate.

The factual background to this appeal and the decision of the LVT

16. 26 Barnes Avenue ("the property") is a three bedroom semi-detached house, of traditional construction under a pitched roof, in a residential development within the Cefn Glas suburb of Bridgend. Llangewydd Court sold a leasehold interest in the land for development in the early 1970s and the property is held on a 99 year lease from 25 December 1972. A ground rent of £15 per annum was reserved in the lease, with no provision for review.

17. It is agreed that the relevant valuation date is 31 August 2020. At that date the unexpired term was 51.31 years. In the absence of agreement between the parties as to the price payable for the freehold, the respondents served notice under section 21(1)(a) of the Act to have the price determined by the LVT.

18. The LVT dealt with the case on written submissions following an inspection. The tenant's valuer, Mr John Caines FRICS, had assessed the premium at £5,380, using a capitalisation rate of 6.5% for the term and a deferment rate of 5% for the first reversion and freehold reversion. The appellant's valuation expert, Mr Joseph, had assessed the premium at £12,450 using a different methodology which ignored the ground rent payable for the term. He used a deferment rate of 3% for the first reversion and 3.75% for the freehold reversion. Both valuers made a deduction from the agreed standing house value for Schedule 10 rights.

19. The LVT determined the premium at £5,430, preferring the methodology and figures used by Mr Caines, subject to an adjustment in the assessment of the s.15 rent, and making no discount for Schedule 10 rights.

The appeal

20. The appellant, with permission from this Tribunal, argued two grounds of appeal which we consider in turn. The first was that the LVT had used the wrong figure for the current ground rent. Mr Joseph withdrew this point at the hearing and we need say no more about it.

21. The other ground of appeal is that the risk-free rate used as the first element of the deferment rate in *Sportelli* is now incorrect in the light of the very changed economic conditions. Mr Joseph also says that the *Zuckerman* addition for slower growth outside PCL is no longer appropriate, particularly with the impact on the PCL residential property market of the Covid-19 pandemic.

22. Mr Joseph is not alone in taking the view that the *Sportelli* rate depends upon outdated financial data. At paragraph 6.80 of its report *Leasehold Home Ownership* Law Com No 387 (2020) the Law Commission reported on the response to its consultation question whether the deferment rate should be prescribed by statute:

> "…it was suggested that prescribing deferment rates at market levels could increase enfranchisement premiums, rather than reduce them. That was based on the view that enfranchisement premiums are currently based on deferment rates that are, in fact, below market values."

23. It is fair to say that the LVT gave Mr Joseph's evidence very cursory treatment. It reported his submission that both the decapitalisation rate and deferment rate applicable in assessing the first reversion should be 3%. It also reported his submission that deferment the rate used in assessing the freehold reversion should be 3.75%, but it did not go through his arguments and evidence, merely saying that it preferred the evidence given by Mr Caines for the tenant. At first sight the LVT's decision is poorly explained. Moreover, Mr Joseph argues that the LVT seems to have misunderstood what he was saying. At its paragraph 17 the LVT observed that returns to landlords are currently low in the aftermath of the pandemic but said that the decapitalisation rate was bound to be higher than high street rates. In answer Mr Joseph says that he refers not to short-term consequences of the pandemic (on the contrary, he says, rents in Bridgend are currently high) but that he is looking at longer-term trends.

24. However, on examination of Mr Joseph's evidence we take the view that for the most part its quality is such that it is unsurprising that the LVT appears to have given it no weight, although some explanation of that would have been helpful to the appellant.

25. Looking first at the risk-free rate, Mr Joseph's arguments, and the evidence that supported them, in his report to the LVT were as follows (paragraph numbers refer to his expert report):

    a. Risk-free real returns have reduced massively since 2006; at 6.1(d)(a) he observes that the Bank of England's base rate has changed from 4.75 to 5% in 2006 to 0.1% in 2020. Attached to his paper is a schedule of base rates; its source is not apparent. However, base rate is a published figure and arguably no expert evidence is required to say what it is or has been.

    b. At 6.1(d)(b) and (c): the UK government was able in August 2020 to borrow money short-term at negative rates; no supporting evidence is offered. He goes on to say that the UK government was able to borrow money for 10 years at a fixed rate of 0.25% during August 2020, and provides the source for this in a newspaper cutting from the front page of The Daily Telegraph on 8 September 2020. The article is about the furlough scheme, and there is a one-sentence reference to the borrowing rate to which Mr Joseph refers, with no source given.

    c. 6.1(d)(d): 50-year fixed-rate government bonds in 2020 gave a rate of return within a range of 0.5-0.59%, whereas long-term fixed rate bonds in 2006 were yielding around 4%. He attaches a note by the UK Debt Management Office setting out gilt yields in 2006 but provides nothing to support what he says about the 2020 rates.

d. 6.1(d)(e) and (f): five-year National Savings Index Linked Bonds were giving 0.01% interest in August 2020, and have not risen above 0.25% in the last five years. In 2006 the fourteenth edition offered 1.15% in November while the thirteenth gave 1.05% in May, and rates were similar in the five years prior to 2006. Mr Joseph refers to "NS&I statistics" attached, referring to a table of rates of unknown provenance. He goes on to say that National Savings has reduced its rates for most fixed rate products to 0.01% in 2020, and provides an undated cutting from an unidentified newspaper to support the latter assertion.

e. Finally on the risk-free rate Mr Joseph draws attention to the discount rate fixed by the Lord Chancellor for personal injury damages, under the under the Damages Act 1996, as amended by the Civil Liability Act 2018, which was set at 2.5% in 2001. In 2019 it was set at -0.25%, and it has been as low as -0.75% in the last five years.

26. Beginning with that last point, Mr Joseph has no expertise in personal injury damages, but the rates set by the Lord Chancellor are a matter of public record and what he says is correct. This is a significant point in his expert evidence.

27. However, the rest of Mr Joseph's evidence is anecdotal at best. We refer again to the Tribunal's warning that "compelling evidence" is required to shake *Sportelli.* Newspaper articles will not cut it. More importantly, the best that Mr Joseph can offer is information. Even assuming all his figures are correct – and of course it is common knowledge that interest rates have fallen since 2006 – Mr Joseph has no expertise in investment forecasting or economics and cannot tell us to what extent the fluctuation we have seen in recent years would have surprised those who gave evidence in *Sportelli* or is indicative of new long term trends. Nor does the evidence show to what extent rates in 2020 were affected by what may or may not be short-term factors arising from the pandemic. Nor does Mr Joseph's evidence come anywhere near to showing what the risk-free rate should be even if it is the case that investment returns have moved outside the range that was determined in *Sportelli.*

28. Mr Joseph argued that in the light of current investment returns the finding that the risk-free rate is 2.25% was one that no reasonable tribunal could have made. In so arguing he has misunderstood what the LVT was doing. It did not make a finding about what the risk-free rate is. Instead it relied upon the guidance case and adopted the rate set out there, in the absence of compelling evidence sufficient to displace the risk-free rate in *Sportelli*

29. Such evidence would have to be given by one or more experts with experience in economics and financial forecasting, rather than only in valuation, and would be supported by robust and properly-attributed data. No doubt the Lord Chancellor's discount rate for personal injury damages would be referred to and might well be regarded as significant, but the Tribunal would need expert evidence as to exactly what that significance was.

30. We turn to Mr Joseph's argument about the decision in *Zuckerman.* The deferment rate used by the tenant's expert witness in his calculations and accepted by the LVT was 5%, and no explanation is given either by Mr Caines or by the LVT as to why that figure is used rather than the 4.75% determined in *Sportelli* for houses. We infer that the additional 0.25% is to

allow for lower growth outside PCL, in line with the Tribunal's decision in *Zuckerman*; the figure used in *Zuckerman* was 0.5% and it may be that since Mr Caines claimed only 0.25% the LVT simply accepted that lower figure. Mr Joseph's evidence to the LVT was that there should be no such addition because changing work patterns as a result of the pandemic are reversing the rental growth differential between PCL and Bridgend. He attached two newspaper cuttings to his report, both of which are anecdotal and say nothing about property values. We attach no weight at all to this evidence.

31. Accordingly, while we would have liked to see an acknowledgement of Mr Joseph's arguments in the LVT's decision and an explanation as to why it could not be given any weight, we decline to set aside the LVT's decision on the basis that the LVT was wrong about the risk-free rate or about the additional discount based on *Zuckerman*. On the evidence offered to it, it could have reached no other conclusion.

Conclusion

32. The appeal fails and the LVT's decision stands.

33. As we observed at the start of our decision, that is not to say that the appellant's point was not arguable. The appeal failed because it became clear on examination of what had been placed before the LVT that it could have reached no other conclusion. Whether the appeal could have succeeded had it been supported by compelling expert evidence may be a question for another day. Whether any landlord would think it worthwhile in future to mount such an argument at a time when reform of the whole basis of the premium payable on enfranchisement is on the cards we do not know.

Upper Tribunal Judge Elizabeth Cooke Diane Martin MRICS FAAV

14 October 2021