

Relativity post Mundy: Are lease extension premiums set to increase for flat owners?

Introduction

The premium payable to extend a flat lease may increase as a result of a new method of calculating one of its key components following the decision in *Sloane Stanley Estate v Mundy* [2016] UKUT 223 (LC).

Flat owners pay a premium for a new lease. One of the potential components of the premium depends on the relative value of the flat with and without an extended lease. Where you set this “relativity” can have a big effect on the premium payable.

It is complicated by the right to claim an extended lease being a form of compulsory acquisition and so subject to an assumption that the right does not exist when you assess value. This is often referred to as the “no act world” (or more accurately a bubble).

Historically, relativity had been based on industry accepted graphs alone. The Sloane Stanley decision has changed this and so potentially the level of premium payable by flat owners for an extended lease.

The reliance on graphs was challenged in the Sloane Stanley case by an assertion that these graphs were flawed such that you should look to the relativity that applied before the relevant legislation was thought of; in short that the pre Act world was the “no act world”.

In Sloane Stanley, this challenger methodology produced a result that could not be true and so it was rejected; it was referred to as a clock that struck ‘13’. Unfortunately the existing graphs were

either dismissed or found to be wanting. As a result evidence of real world relativity is preferred where it can be found. If absent then reference to graphs can still be made, albeit with a greater emphasis on the valuer applying their judgment. Sloane Stanley says (paragraph 169) that valuers need to consider adopting more than one approach; “One possible method is to use the most reliable graph for determining the relative value of an existing lease without rights...another method is to use a graph to determine the relative value...with rights...and then to make a deduction...to reflect [their] absence...[if] the methods throw up different figures it would then be for the good sense of the experienced valuer to determine what figure best reflects the strengths and weaknesses of the two methods...”.

So real world relativity is preferred (if it can be found). It may be prove to be lower than where the graphs placed it and so increase the premium payable. It might fluctuate with location. Where it cannot be found reference to the graphs is to be made.

As a consequence the premium payable is less certain and the scope for dispute is likely to be greater until a body of decisions develops.

The Upper Tribunal have applied the Sloane Stanley decision in the cases of *Denholm v Stobbs* [2016] UKUT 288 (LC) and *Mallory v Orchidbase Ltd* [2016] UKUT 0468 (LC). The first instance decision referred to below is also interesting.

Denholm v Stobbs

The Denholm decision is interesting for a number of issues. The landlord, who represented herself, forced issues to be canvassed that might not ordinarily have reached this stage. The case concerned a lease extension claim made by Candida Stobbs in respect of her upper maisonette at 12 Needham Road, Notting Hill, which she held on a full repairing and insuring lease (FRI).

Could the demise be shrunk in the new lease?

No; Miss Stobbs' initial notice had proposed that her repair responsibility be pushed on to the freeholder's shoulders in return for the usual service charge provisions being put in place. The freeholder rejected this but then sought the same and more by proposing that in the new lease the external walls and roof be removed from the demise. Not surprisingly the Upper Tribunal gave short shrift to this firstly as the First Tier Tribunal did not have this issue presented to it in the earlier decision. Secondly the FRI structure of the existing lease didn't represent a defect that such a change might be founded upon. Thirdly in the absence of agreement the Tribunal had no power to order the grant of a new lease on less than the extent of the existing demise.

Relativity

The Upper Tribunal followed the Sloane Stanley decision by confirming that "ordinarily [the price paid for the short leasehold interest originally] would have been the best guide to value once adjusted for Act rights. In its absence we look to the relativity graphs." Sloane Stanley set this out with the caveat italicised here "if the price paid [for the existing lease with rights] *was a true reflection of market value*...then that...would be a very useful starting point for determining the value of the existing lease without rights..." and explained it fell to an experienced valuer exercising their judgment as to the amount of deduction that would be appropriate to reflect the no Act bubble.

The Upper Tribunal found that the Gerald Eve (GE) graph would have been the starting point and endorsed the Sloane Stanley finding that the Gerald Eve graph might overstate relativity and so reduced the relevant figure by 1%. They also made a discount to reflect the "unusual" lease term which had been agreed at 1.55. That

produced a relativity of 66.2% for the term of 43.37 years. They rejected the Savills 2002 enfranchiseable graph as a starting point, finding it to be too high.

Mallory v Orchidbase Ltd

This case concerned three long leasehold flats in Hemel Hempstead with 57.68 years unexpired. The issues in dispute were the unimproved freehold value of each flat and relativity. The matter was dealt with by way of a re-hearing.

Three points of interest came out of the unimproved freehold value issue being considered:

- 1) The Tribunal can have regard to transactions which complete after the valuation date – the Upper Tribunal endorsed the First Tier comment that "although the valuation date is fixed, events occurring after that date may be relied on as evidence of values on that date (subject to any appropriate adjustment)."
- 2) The usefulness for comparable is not adversely affected by the relevant flat having a share of freehold – they accepted that "a share of the freehold would make little difference to value when considering long lease values."
- 3) When adjusting for time the Land Registry index was preferred (over the Nationwide Building Society house price index for the outer Metropolitan area) since monthly data points were available from it.

With regard to relativity, following the decision in Sloane Stanley market evidence was found to trump relativity graphs. The tenant had adopted an average of certain graphs including the graphs for Greater London and England (Beckett & Kay, South East Leasehold, Nesbitt & Co, Austin Grey and Andrew Pridell Associates Limited) together with the John D Wood & Co (1996) and Gerald Eve graphs. The landlord relied on comparable evidence then applying a deduction for Act rights based on the differential between the Savills (2002) Enfranchiseable graph and the Gerald Eve (1996) graph which produced a relative reduction of 5.5%.

It helpfully recited the findings in Sloane Stanley as follows:

- a) If there is a market transaction around the valuation date in respect of the existing lease with rights and the price paid was a true reflection of market value then this “will be a very useful starting point for determining the value of the existing lease without rights” - it falls to the “experienced valuer” to express their independent value as to the deduction that should be made for rights.
- b) If absent then more than one approach needs to be considered potentially including:
 - I. Use the most reliable graph to determine whether to value the existing lease without rights; or
 - II. Use a graph to determine relative value with rights and then make a deduction for rights on the statutory hypothesis;

If those throw up different figures then “the good sense of the experienced valuer” is to be applied to determine the figure that best reflects the strengths and weaknesses of the two methods.

In this case they were satisfied there was sufficient market evidence being two transactions on very similar properties with virtually identical unexpired terms besides a market transaction in one of the appealed flats. The deduction of 5.5% for Act rights was accepted as being modest and consistent with the findings in Mundy where a deduction of 10% was made for an unexpired term of 37 years and 20% for 23 years. They stressed that each case must be considered on its merits though.

First instance decision

The first instance decision of *Ramazani v Sinclair Gardens Investments (Kensington) Limited* LON/00AX/OLR/2016/0697) was brought to the attention of the Leasehold Forum Conference by Geoff Holden, who had acted for the respondent landlord and covered similar terms. It highlights a few points which are worth noting;

- a) Onerous ground rents limit the reliance that may be placed on the RICS graphs - due to that and the decision in Sloane Stanley local transactional evidence was preferred:
- b) The deductions for Act rights referred to in the Sloane Stanley case were recited being 11.82 years: 20%, 17.8 years: 25%, 18.7 years: 15%, 37.7 years: 10 % and 44 years: 7.5%
- c) A comparable was discounted for being too old at 2.5 years prior to the valuation date
- d) The freeholder’s argument that there is no difference in the open market between a lease of 154.17 years and its freehold value was accepted on the basis that there is no demand/market for freehold flats in London, the lack of mortgage finance and the inherent difficulties enforcing positive covenants.

Conclusion

Relativity will need to be determined on a case by case basis. Where reliable comparables can be found that will trump the graphs. If absent then valuers will have to do the best they can using their own judgment.

Relativity may be found to be lower so increasing the premium payable for a new lease, particularly outside prime central London.

Valuers may have mixed feelings; on one hand they will be pleased to see that their skills are being utilised to a greater degree in particular where there are available comparables. On the other hand they have their work cut out and the person paying their bill may need to be educated in this regard.

Over time there will be less short lease comparables and this may make agreement more difficult to achieve and operate to depress relativity so increasing the premium payable for a new lease. It may become apparent that there are various factors affecting relativity and that this is highly localised.

Where reference to the graphs needs to be made it may become less clear what the market was responding to at the relevant valuation date.

There may be a reduction in challenges to the relevant graph in view of the Upper Tribunal’s comment “The parties and the Tribunal must focus on the state of the market at [the valuation] date...if the market at a date in the past was influenced by a particular graph of relativity then that influence is a market circumstance which is to be taken into account. It is not open to a party when discussing the market at a date in the past

to suggest that the market was badly informed or operating illogically...”.

On the other hand there may be new battles to be had as it anticipates that new graphs might emerge (paragraph 167) and accepts that there will be a feedback loop between market forces and Tribunal determination and accepts that where that occurs then the changed market circumstances (net of the relevant decision) must be taken into account when considering market value and so the Tribunal may lead the market rather than following it. No doubt this is how they allowed a reduction of 1% in the Stobbs case.

While the industry gets used to the shift there may be some settling in involving a greater number of matters going as far as Tribunal and so magnifying the cost of the process to the parties.

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