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Enfranchisement Feature 2013

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This pull out and keep guide to enfranchisement introduces the key concepts and is written by independent industry practitioners.

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A RESOLUTION WORTH STICKING TO

Check the length of your lease and take immediate action if necessary.


Alex Greenslade

AS 2013 GETS UNDERWAY and best intentions made on New Year's Day start to fall by the wayside, **Alex Greenslade, Honorary Secretary of ALEP** (the Association of Leasehold Enfranchisement Practitioners), urges flat owners to stick to one important New Year's resolution – to check the length of their lease.

At the end of December, and at other times throughout the year, the length of many flat owners' leases becomes one year shorter. The inherent value of a flat is linked to the length of its lease, which many fail to appreciate, until they come to sell and find out the hard way that they should have tackled the issue proactively. When they are in this situation, they often have little room for manoeuvre and are forced to agree terms for a lease extension with a freeholder that are inferior to their legal entitlement, and often costlier.

Alex Greenslade says: "For most people the years pass faster than they expect and often a lease that one thought was comfortably above the 'danger zone' (typically 85 years or less outside central London) is actually in dire need of attention.

"It does not have to be like this. At the very least, if flat owners know exactly how long their lease is, they will not be caught out. Not only should they take action before it becomes a problem, but they should also be aware of the exact date when the lease is going to slip below the crucial 80-year level, after which the freeholder could be entitled to receive thousands of pounds more to extend the lease in the form of 'marriage value'.

"If you own a flat, stick to one New Year's resolution – check the length of your lease as it could save you thousands of pounds!"

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LEASEHOLD ENFRANCHISEMENT OR RIGHT TO MANAGE? A LESSEES' CONUNDRUM

Anna Favre and Amy Chance explain.

Leasehold owners have two rights afforded to them if they wish to take over the management of their building. First, the Leasehold Reform, Housing and Urban Development Act 1993 enables leaseholders to acquire the freehold of their building following a collective enfranchisement claim. Secondly, the Commonhold and Leasehold Reform Act 2002 permits leaseholders to take over the management of their building.

Apart from the obvious benefit that comes with a collective claim, securing the ownership of their building, leaseholders need to consider whether the advantages of enfranchisement outweigh those of a right to manage claim. This is not always a straightforward exercise and depends largely on the resources and objectives of the parties concerned.

Before exercising either right leaseholders must establish whether the qualifying criteria is met to make a collective enfranchisement or right to manage claim.

QUALIFYING CRITERIA

For both collective enfranchisement and right to manage, the criteria are similar. Briefly, the building must be a self-contained building or part of a self-contained building, not more than 25% may be used for non-residential purposes (excluding the common parts), two or more flats must be held by qualifying tenants and qualifying tenants must own at least two-thirds of the total number of flats in the building. In addition, 50% of the total number of flat owners must participate in a claim.

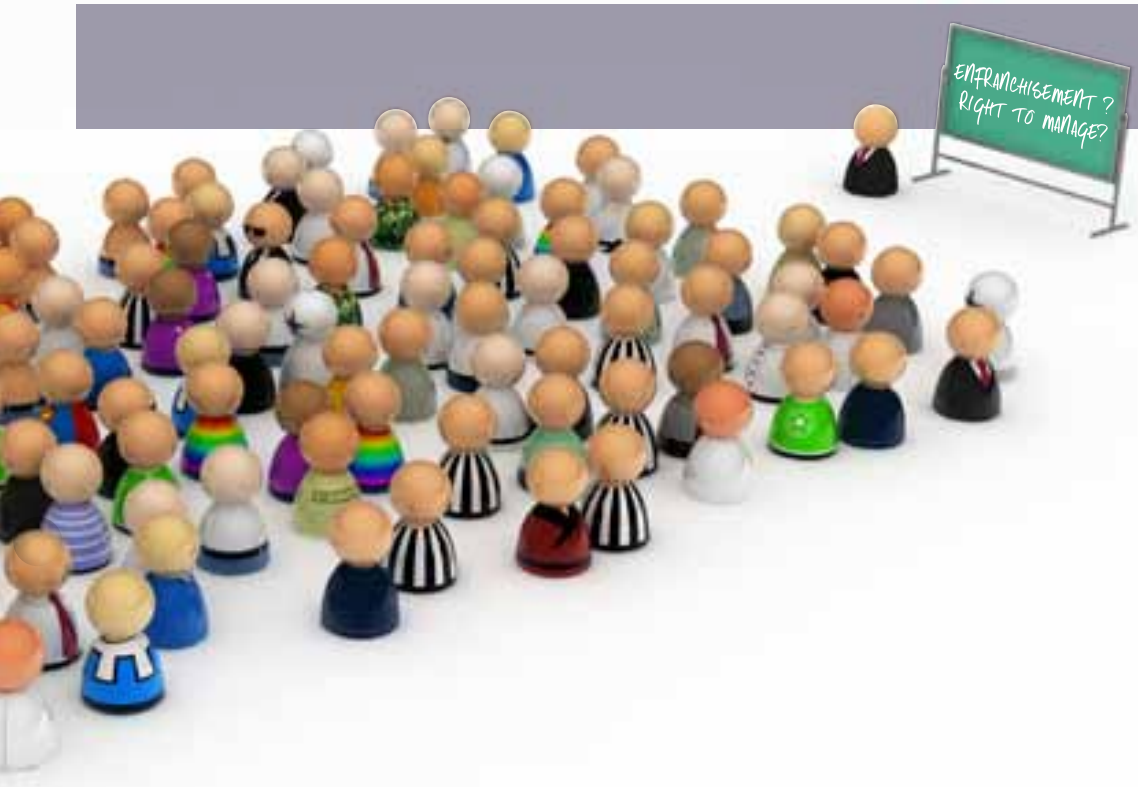
PROS AND CONS OF ENFRANCHISEMENT

Pros In most cases the collective enfranchisement of a residential building will be the best option for leaseholders. This will enable them to gain complete control and ownership of the building and in turn grant themselves (as leaseholders) new 999 year leases for no premium. The value of their interests may therefore be enhanced. Market perception is that purchasing a flat with a share in the freehold is preferential to buying a leasehold interest so this provides more good news for leaseholders.

Leaseholders with a high ground rent should also be attracted by the enfranchisement option as rent can be reduced to a peppercorn on granting the new leases. There is also potential investment value for third parties willing to fund the cost of enfranchising non participating flats - so called White Knights. For lessees constrained by a budget, this option can prove invaluable and enable a collective claim to proceed where it might otherwise fail for lack of funds.

Cons The enfranchisement process can be protracted, the average claim taking approximately two years. Leaseholders will need to budget carefully, not only for their own costs and the premium but a significant proportion of the landlord's costs which the Act says they must pay.

If the enfranchisement is to be a success following completion, it is vital there is an efficient and cooperative group of residents willing to oversee the management of the building and its ownership structure for many years to come. Although a managing agent can be appointed, the necessary involvement from some leaseholders may be onerous with issues such as maintenance, improvements, licences to assign or alter, noise nuisance and company administration in the offing. Leaseholders should consider carefully whether it is better to have a common enemy in a landlord than be embroiled in arguments with their neighbours.



> From the outset leaseholders should be clear on their objectives. There is little point in completing a right to manage claim if this proves a short term and ineffective solution

PROS AND CONS OF RIGHT TO MANAGE

Pros A right to manage claim will be cheaper than making a collective enfranchisement claim as there will be no valuation fees, nor is there a premium payable. If finding a resolution to management problems is the leaseholders' main objective and cost is also an issue, a right to manage claim may be the best option.

Cons It would be a misconceived to suggest that after the tenants have gained control of the management of their building the problem landlord will disappear from sight. A right to manage claim enables leaseholders to take over the building's management functions such as services, repairs, maintenance, insurance and improvements. However, a landlord will not be completely absolved from their management duties. Landlord and lessee will still need to work together.

The legislation requires that landlords must be given notice before the Right to Manage Company (set up by the leaseholders following completion of the claim) may grant approval relating to assignments or alterations. If a landlord objects, the RTM company may not grant consent. In practice this may delay the decision making process as an additional party has been introduced. The statutory notice periods will also be likely to jeopardise time sensitive transactions.

CONCLUSION

From the outset leaseholders should be clear on their objectives. There is little point in completing a right to manage claim if this proves a short term and ineffective solution, the problem landlord remaining in the frame. Similarly, with collective enfranchisement foresight and planning is key. Without an honest assessment of whether leaseholders are willing to take on the long term ownership of a building, and its associated challenges, rancour and disagreement may be closer than they anticipated.

As with so many leasehold matters, there is no right answer or a one size fits all solution. But with some careful planning and proper advice, leaseholders can choose a remedy that is just right for them!

Anna Favre is a Partner and Amy Chance is a Solicitor at Pemberton Greenish LLP

"PING-PONG" FREEHOLDS!

Yashmin Mistry explains a legislative loophole

The 50% Participation Rule!
As enfranchisement is a group action, a common question often asked is, "do all my neighbours need to take part?"

Under the legislation, the participating tenants must be those of the flats comprising not less than 50% of the total number of flats on the notice of claim is given (unless there are only two flats in the building, both flats must participate).

Note, that it is the total number of flats in the building. In other words, this includes those of qualifying tenants and of all the other flats in the building.

So, for example, in a block of 23 flats, at least 16 (two-thirds) must be held by qualifying tenants and at least 12 qualifying tenants (50% of the total number of flats) must participate.

Is there a Right to Participate?
When exercising the Right to Manage process there is a mandatory requirement that before a claim notice is served the RTM company must give notice to all qualifying tenants who are not members or who have not agreed to become members of it.

This mandatory requirement, at least until the Right to Enfranchise Company legislative provisions are bought into effect, **do not** apply to collective enfranchisement claims.

There is **NO** right to participate or to be invited to join in the freehold purchase and whilst it may be useful to ensure all tenants are aware of the proposed acquisition, there is at present no legal obligation to do so.

So what does this mean?
Quite simply, providing the application for the purchase of the freehold is supported by the correct number of participants, the remainder of the leaseholders can effectively be "blocked" from the process.

If this is true, what is there then to stop the remaining tenants serving a separate notice ascertaining their rights to exercise the right to collectively purchase from the tenants that have just bought the freehold?
Answer: Absolutely nothing providing there are sufficient numbers to support the claim! (at least until after the initial notice of claim no longer carries force).

HEALTH WARNING!
Whilst it is harder to envisage such a situation in larger blocks due to the number of participating tenants that need to be obtained, there is much larger scope for freeholds to "ping-pong" between tenants in much smaller blocks.

This can lead to potentially disastrous consequences not only for the relations between tenants within the block they live but also for management issues on a longer term basis.

Whilst the requirements under the right to manage provisions on the face of it seem quite onerous in that there is a mandatory requirement before serving the notice of claim to inviting all qualifying tenants to take part, if applied to enfranchisement claims, would this avoid the potentially disastrous consequences where freeholds "ping-pong"?

Is it time that the Right to Enfranchise Company provisions under the Commonhold and Leasehold Reform Act 2002 are actually brought into force?

Yashmin Mistry , Partner, JPC Law

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WHY 2013 MAY BE TIME TO ENFRANCHISE IN PRIME CENTRAL LONDON

Claire Allan explains.

Not to generalise, but enfranchisement can broadly be divided into three groups. Those who extend their lease; those who purchase the freehold of their house; and those who, collectively with their neighbours, purchase the freehold to the block within which they own a flat. There is surprisingly, an ever emerging fourth category. These are the flat owners who do nothing but sit on their ever diminishing asset. The expression 'resting on one's laurels' could be said to be put to mis-use in the context of ownership of a prime central London flat on a short lease. For the purposes of this article let's concentrate on this latter group.

2013 marks twenty years since the enactment of the Leasehold Reform, Housing and Urban Development Act 1993, the piece of legislation which permits leaseholders to extend their lease or collectively purchase their freehold. The right to purchase the freehold of one's house has been around for even longer, approaching fifty years.

Indeed the legislation has only improved, from the leaseholder's point of view, since its introduction. The biggest changes include the fact that now there is now no requirement for the leaseholder to reside in the flat. The number of leaseholders in a building required to participate in a collective claim to purchase the freehold is now only one-half, it was originally two-thirds. And a building still qualifies so long the commercial parts do not exceed 25 per cent, previously it used to be a maximum of 10 per cent.

So why is there a pool of leaseholders who allow their lease length to diminish into unchartered waters? Perhaps enfranchising is on every leaseholder's 'must-do' list? Some would argue that the urge to keep track of our assets be approached on a reactive basis: by waiting for someone else in the building to organise a collective acquisition of the freehold or by tackling the issue of the short lease length when selling the flat.

A New Year means not just resolutions but predictions too. Prime central London market supremos have given broadly unanimous verdicts in terms of optimistic growth levels for 2013, the eurozone is looking more stable than it has done for some time and some lenders have their appetite for lending back, but of course only in relation to the right assets and the right clients. Demand in 2013 will more than likely continue to boom – so long as foreign buyers keep coming in the same numbers.

So what do such market forecasts mean in terms of short leases? A short lease (or a lease with less than 80 years remaining), is, in a stable or rising market, a diminishing asset. 90 years may be added to its term under the legislation once you have owned the flat for two years, or, better still, join in a collective claim to purchase the freehold and thereafter extend your lease to 999 years. Foreign buyers are, in particular, very alive to the issue of lease length.

Claire Allan is a Partner at Child & Child

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CAN YOU ENFRANCHISE A "HOUSE"?

Natasha Rees interprets a long awaited Supreme Court decision.

The "Hosebay" appeals, brought by two central London Landed Estates, were challenging a Court of Appeal decision that a property used wholly for commercial purposes could qualify as a "house" under the Leasehold Reform Act 1967 ("the Act"). The Supreme Court unanimously allowed both appeals.

To satisfy the test of whether a building is a "house" under Section 2(1) of the Act, the building must be "designed or adapted for living in" and "a house reasonably so called".

The judgement stated both parts are complementary and overlapping but need to be satisfied at the date of the notice of claim. When considering whether a house is "designed or adapted for living in" it is necessary to look at the identity or function of the building based on its physical characteristics. When deciding whether the building can "reasonably be called a house" it is necessary to consider its settled use rather than its physical appearance.

On this basis, the buildings in Day v Hosebay (which were converted into flatlets for use as short term accommodation for students or overseas visitors) could not be called houses. The fact they look like houses or be referred to as houses was not sufficient: their use was entirely commercial. In Howard de Walden v Lexgeorge, which concerned a town house in Marylebone sub-let as offices to a solicitors firm, since it was wholly used as offices it could not be a "house reasonably so called".

The judgment, which contains both legal and policy reasons, is aimed at closing the loophole that allowed tenants of commercial buildings to acquire their freehold. Consequently, numerous claims have been withdrawn, including those in Mayfair, Harley Street and Chelsea.

> **"Although the judgment is clear that a building wholly in commercial use will not qualify, it is not the final word on "houses" everyone had hoped"**

Practitioners now have to consider how best to apply the test going forward. The internal and external characteristics of the property and its current use at the date of the claim must be considered. If the "function" of the building is to be lived in then it will be a "house". If wholly or even substantially in commercial use it is unlikely to qualify.

The problem is the test appears to rely on the use of the building at the date of the claim notice. If correct, a tenant need only vacate a building prior to claiming. It is also difficult to see how the test is applied to a mixed use building or one stripped out so none of the previous design or adaptation is apparent.

Another issue is what constitutes commercial use. Here, short term letting of studio flatlets was a commercial use and each building could not "reasonably be called a house". However, where a property is subdivided into flats let for slightly longer periods, when does it become a place to "live in" rather than a business? Although the judgment is clear that a building wholly in commercial use will not qualify, it is not the final word on "houses" everyone had hoped for.

Natasha Rees is a Partner at Forsters LLP

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CAPITALISATION RATES: THE NEXT MAJOR BATTLE GROUND IN ENFRANCHISEMENT?

John Stephenson reports on the "23 Pont Street" decision

In April 2012, the Leasehold Valuation Tribunal gave judgment in the 1967 Act case of 23 Pont Street, London*. Although a house for enfranchisement purposes, the property was divided into seven flats, including one occupied by the leaseholder and another by a housekeeper. The other flats were let on rack-rent tenancies.

The lease was unusual. When granted in 1978, with a starting rent of £2,000 per annum, five-yearly reviews were imposed by reference to 2% of the freehold value of the property at the review date. By the time the freehold was claimed in 2010, the rent had risen to £225,000 per annum, and was virtually a rack rent. The use was also restricted, confining (in simple terms) the flat to furnished lettings for terms not exceeding five years. None of the flats would therefore be sold off on long underleases, and the leaseholder's interest was limited to the profit rents over and above the very high ground rent.

The amount of ground rent meant its capitalisation was a significant component of the overall valuation. The landlord's expert said that normally a capitalisation rate of 5% would apply, but this rent was so high, and the reviews so in favour of the landlord, it was appropriate to base the rate on a risk-free rate with an uplift, resulting in a rate of 2.25% for the passing rent and 2.5% for the future rent. The tenant's valuer disagreed, the quantum of the passing rent being irrelevant to the established principles to be applied. Even considering market evidence for net rental yields, he felt the rate should be 4.75% for the passing rent and 5.25% for the review rent.

In its decision, the LVT reminded the parties it was an expert Tribunal, following neither value. The Tribunal separated the issues affecting the capitalisation rate from the deferment rate, and instead based their decision on the net rental yield for flats in the area as set out in the Savills Index (namely 2.4%, with a 2% uplift to reflect the expectation of capital appreciation). The freehold investor was acquiring an income with reviews based on the capital values of the flats, where because of the lease terms, the resultant rent is approaching the rack rent every five years. The flat tenancies themselves were of single properties with annual reviews to market rents, which may periodically increase faster than capital values. With the landlord also having the ability to obtain vacant possession, they were very attractive as an investment.

Capitalisation was not the only issue – the landlords tried reducing the deferment rate from the Sportelli 4.75% to 4.25%, but this was also rejected by the Tribunal.

Rather to the parties' surprise, neither the LVT nor Upper Tribunal gave leave to appeal on capitalisation, but the case is a strong sign that, especially where ground rents are significant, the capitalisation rate to be applied could be the next major battleground for enfranchisement practitioners. Moreover, the deferment rate will not be far behind!

John Stephenson is Senior Partner at Bircham Dyson Bell LLP

*Earl Cadogan and Cadogan Estates Limited v Brahm

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HOW DEVELOPMENT VALUE AFFECTS THE CALCULATION OF THE FREEHOLD

Roger Nelson explains

Development value is often raised in a collective freehold purchase, causing confusion, muddled thinking and unnecessary references to Tribunal.

As with all valuations the amount depends on how a potential purchaser looks at the opportunity; what is it and is it physically possible? How long will it take and how much will it cost? Is there planning permission or is it likely? What are the risks? How much do I need to set aside for this?

Schedule 6 of the 1993 Act tells us how to deal with this. Paragraph 3 concerns development taking place at the end of the lease or during the lease without trespassing on the lessee's land or where there are reserved rights in favour of the landlord. Examples include an additional floor on a flat roof or within a roof space.

Paragraph 3 takes into account the hope of non-participating tenants seeking new leases of their respective flats and can deal with the hope that development will take place during the lease by negotiation. Much of the wording in the House of Lords decision Cadogan v Sportelli (from Para 96) applying to hope value of non-participating tenants can apply to the hope of development value. It would be calculated in a similar way to Marriage Value but with a further discount reflecting the need for agreement.

Whilst assessed similarly to marriage value it is not marriage value. Therefore, the hope of development can be included whether or not the leases are below 80 years unexpired and whether Marriage Value under Paragraph 4 is payable.

Paragraph 4 applies where development can only take place where the developer (freeholder or leaseholder), can acquire land or can obtain a release of a covenant from the other party to the lease. Development value here is part of "marriage value" and applies where the leases are 80 years or less.

> **"The financial incentive for the leaseholders is that once the freehold is under their control through the nominee purchasing company they can grant themselves long leases on different terms"**

The financial incentive for the leaseholders is that once the freehold is under their control through the nominee purchasing company they can grant themselves long leases on different terms. This can include the grant of a new long lease which allows development previously impossible. Such development may include the roof space, or a basement excavation.

Paragraph 5 compensates for a loss of other adjoining property following the acquisition of the freehold. This specifically mentions "loss of development value" (eg: the inability to redevelop a block, part of which owned by the lessees). Do not confuse compensation for loss of adjoining property here with development value arising within the garden and grounds which is "Appurtenant Property" (defined in section 1 (7) of the Act). The latter is considered under paragraphs 10-13 where similar considerations as in paragraphs 3, 4 and 5 apply.

Roger Nelson FRICS, IRRV (Hons) is a Director at Each Side Leasehold. Member of Association of Leasehold Enfranchisement Practitioners

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AVOIDING THE RIGHT TO MANAGE

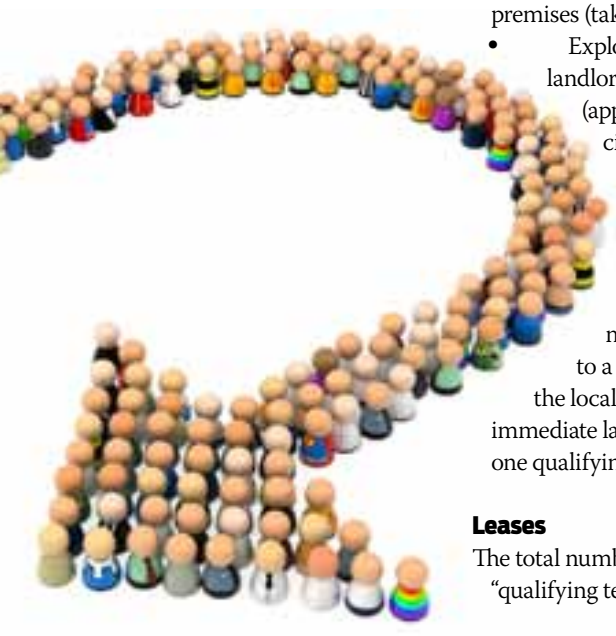
Roger Hardwick explains why RTM is not for everyone

The right to manage divides opinion. C&LRA 2002 provides that any agreements purporting to exclude or modify the right will be void.

Arrangements can be created so the required qualifying conditions are not met and, if not a sham, successful avoidance is possible.

Building

The premises must either be a self-contained building or part of a building. At development, it may be possible to construct a building which falls outside the scope of the Act; for example, by ensuring the block is connected to (i.e. not "structurally detached") and not divided vertically from another structure (a clean vertical division is required). Subterranean underhangs and overhangs could be used. The meaning of "structurally detached" is due to be clarified by the Upper Tribunal this year.



Excluded Premises

Schedule 6 contains a list of premises excluded from the right to manage. These include:

- Ensuring the internal floor area of non-residential parts exceeds 25 per cent of the total internal floor area of the premises (taken as a whole).
- Exploiting the "resident landlord" exclusion (applies in limited circumstances).
- Selling or gifting a concurrent intermediate lease of one or more apartments to a local authority, so the local authority is the immediate landlord of at least one qualifying tenant.

Leases

The total number of flats held by "qualifying tenants" must be not less than two-thirds of the total number of flats contained in the premises. A landlord could create an arrangement whereby more than one third of the flats in a given block are not let to qualifying tenants; by (for example):

- Letting the flats out on assured shorthold tenancies;
- Granting leases for a period not exceeding 21 years with options for non-perpetual renewal, and provision for a small premium on the grant of each renewal.
- Granting leases to which Part 2 of the Landlord and Tenant Act 1954 (business tenancies) applies. Serviced apartments might satisfy this definition if the leaseholder retains substantial control and provides a comprehensive service.

RTM Company

A landlord can incorporate their own RTM company (with at least one qualifying tenant member) to prevent another RTM company exercising the right; however, any qualifying tenant could apply to become a member of the first company, so this is a risky strategy.

If the landlord owns enough qualifying flats, he could exercise the right himself, or at least incorporate a RTM company control would be retained.

Where a winding up order is made against a RTM company, the right ceases to be exercisable in the premises and may not be exercised for a further four years. A landlord may serve a winding up petition on a RTM company; for example, where it is unable to meet the landlord's costs pursuant to s.88 of the Act.

Management Functions Outside the Lease

Finally, the RTM company acquires only those "management functions" belonging to a landlord under a lease of the whole or any part of the premises (or a party to such a lease otherwise than as landlord or tenant). Where management functions derive from another source (eg a management company recovering a contribution towards its expenditure, under its Articles of Association), arguably the 2002 Act has no application.

Roger Hardwick is Head of Leasehold Enfranchisement at Brethertons LLP

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HOW TO REACH MARKET VALUE

James Wilson examines the comparable method of valuation in leasehold reform cases.

The comparable method of valuation is an established tool in the valuer's armoury to reach opinion of market value. Here we examine how the Upper Tribunal (UT) applies the "comparable transaction" method to meet specific requirements in leasehold reform.

ANALYSIS OF COMPARABLE SALES

'…A comparable can be broadly defined as an item used during the valuation process as evidence in support of the valuation of a different item of the same general type…' RICS information paper 'Comparable evidence in property valuation', 1st edition'.

For any evidence to be regarded as comparable evidence it needs to be: (1) comprehensive – ideally a number of transactions; (2) very similar; (3) recent; (4) arm's length, open market; (5) verifiable; and (6) consistent with local market practice.

ADJUSTMENTS

In *The Earl Cadogan v Farrokh Faizapour & John Stephenson* [2010] UKUT 3 (LC), a collective enfranchisement in PCL, the UT categorise adjustments as follows:

- Non-physical factors; and
- Physical factors.

Non-physical factors:

- Time, that is for market movement from the sale date of the comparable to the valuation date, by applying an appropriate index; and
- Lease length/relativity.

Physical factors, which include:

- Condition – improvements and disrepair;
- Location, position;
- Floor, GIA; and
- Outside space, ie terrace, garden etc…

The UT say they prefer the adjustments for non-physical factors (time and lease length/relativity) to be made first, followed by those for physical factors (condition, location etc).

The final 'end adjustment', if applicable, is that to be made for the benefit of the Act.

ADJUSTMENTS - WEIGHTING

Having made all of the adjustments the valuer then attributes weight to each, what is also referred to as a hierarchy of evidence. That is to say an opinion is expressed as to whether the comparable sales analysed are to be attributed equal weight, or are to be weighted in favour of one or more. In any event the weighting will add up to 100%.

In *Earl Cadogan v Betul Erkman*, the UT having made the adjustments to the three comparable sales analysed, go on to attribute weight to each: 70%, 20% and 10% - total 100%.

Following on from the above, the UT adopted the same approach in *The Earl Cadogan (and others) v Cadogan Square Limited*, where they set out their decision in tabular form. The adjusted weighted value of £884 psf is applied to the GIA of the subject property.

James Wilson is Head of Valuation at W.A.Ellis and co-author of 'Leasehold enfranchisement explained'. He recently presented at the Leasehold Forum.

Address	Adjusted Value (£ psf)	Weighting (%)	Adjusted Weighted Value (£ psf)
Flat 1, 11 Cadogan Square	1,041	10	104.10
G & B, 21 Cadogan Square	766	15	114.90
G & B, 21 Cadogan Square	937	12.5	117.12
Flat E, 30 Cadogan Square	921	10	92.10
Flat 1, 44 Cadogan Square	937	17.5	163.97
Flat 1, 58 Cadogan Square	777	17.5	135.97
Flat 10, 78 Cadogan Square	890	17.5	155.75
	Total	100%	883.91
		Weighted average, say	£884 psf.

DEVELOPMENT VALUE IN ENFRANCHISEMENT CLAIMS

Piers Harrison highlights the importance of calculating this correctly.

In enfranchisement, development value can arise in three situations. It is important to determine which paragraph of Schedule 6, Leasehold Reform Housing and Urban Development Act 1993, applies as this will affect how development value is calculated - if payable at all.

1 VALUE ATTACHING TO THE FREEHOLD INTEREST ALONE – PARAGRAPH 3

The classic case is where the freeholder has reserved to himself a flat roof and the right to develop. There might be other obstacles to development but the landlord can carry it out without the leaseholders' co-operation, so such cases are calculated using paragraph 3.

The Tribunal calculates development value here by reference to comparable development sites or (less impressively) to a residual valuation, and usually applies a discount for risk. The two main factors considered are (i) the presence/absence of planning permission; (ii) how certain the development can be carried out at the cost suggested. *Arrowdell v Coniston Court (North) Hove Limited* is a good example.

The risk discount varies depending on how good the evidence is that the freeholder could carry out the development. The parties should consider an expert witness on planning and a structural engineer (if any question over structural viability). Where the freeholder has planning consent, can prove the development is structurally feasible and can be done at a reasonable cost etc. a discount of much less than 50% or even no discount may be appropriate.

2 VALUE RELEASED BY THE MARRIAGE OF INTERESTS – PARAGRAPHS 3 AND 4

Development value can also arise where a party to a lease wants to develop but the development is only possible if the developer, (whether landlord or tenant) acquires land or a release of a covenant from the other party. For example, a basement extension to the ground floor flat where the Landlord owns the subsoil; there is an absolute covenant against alterations; or a short lease making the project uneconomic. Another example is converting a building containing flats to a single house, but needing a release of covenant.

There are two elements to such valuation, which is also subject to a risk discount:

1. The value to the landlord of carrying out development at the end of the tenants' leases (Paragraph 3). (Often minimal because development cannot be carried out for many years).
2. The additional value released by an immediate marriage of the interests (Paragraph 4).

The distinction between paragraph 3 and 4 is critical. Using marriage value, the amount due to the freeholder will be automatically halved.

Development value as marriage value has two surprising and probably unintended consequences. First, under paragraph 4(2A), where a lease has an unexpired term of more than 80 years, no marriage value is payable.

Can the freeholder in such circumstances recover development value as hope value? If so, then why cannot every landlord claim hope value where marriage value is excluded? Lord Neuberger considered this in relation to the similar provisions of the Leasehold Reform Act 1967 in *Cadogan v Sportelli:*

"... it appears...unreal to attribute to Parliament the intention to allow ...marriage value..., when it has specifically excluded marriage value from the valuation exercise."

Those comments, however, are *obiter dicta* and thus, although persuasive, not binding. Also, although he considered Schedule 6, paragraph 4 in detail he did not repeat those comments in that context.

As the amounts at stake are often not trifling, those advising a freeholder should continue to contend for hope value until there is binding case law. Valuers are accustomed to calculating the 'hope' that development value will be released.

That leads to the second unintended oddity. For marriage value, whether the tenant is likely to carry out the development is immaterial, whereas for hope value it is crucial. If there is no evidence a tenant wants to carry out a development, it is unlikely hope value would be awarded. LVTs sometimes fail to appreciate this distinction and, when assessing marriage value, wrongly apply a discount because the development may not happen.

Finally, development value is also released by converting a house from flats to a

> **"...it appears...unreal to attribute to Parliament the intention to allow ...marriage value...., when it has specifically excluded marriage value from the valuation exercise"**

single house. This involves a consideration of paragraph 3 and 4. In *31/37 Cadogan Square* development value was awarded under paragraph 3 as there was only a short time until reversion. There was no consideration of development marriage or hope value. In *Themeline Limited v Vowden Investments* the President ruled that development marriage value was not payable where there is an opportunity to convert flats into a house, but on a case on similar facts an argument for development hope value succeeded in *Cravecrest Limited v The Duke of Westminster.*

Cravecrest concerned the enfranchisement of a house worth £4.9m as flats and £7m as a single residence. Was such development claimable as marriage or hope value? The Tribunal followed *Themeline*, so development value could not be claimed as marriage value, but analysing *Sportelli* found it was no bar to recovering development hope value.

3 ADJACENT LAND – PARAGRAPH 5

Often valuation reports lump all development value under paragraph 5 because it is headed "Compensation for loss" and is the only paragraph explicitly mentioning development value. This is a mistake and it is ironic it hardly ever applies.

It clearly only applies where the freeholder has other property, not the subject of the enfranchisement: (paragraph 5 (2)).

Paragraph 5 is only concerned with damage to the freeholder's other property interests caused by the loss of the specified premises (damage caused by the loss of additional property such as appurtenant gardens is dealt with separately). For example, where the premises are a terraced house and the landlord owns the house(s) next door and demonstrates he could have released value by knocking them down or together. The freeholder could claim compensation for the loss of development opportunity for both the specified premises and the neighbouring property.

It is vital to ascertain the correct basis for claiming development value, as it makes a great deal of difference to the end result.

Piers Harrison is a Barrister at Tanfield Chambers. This article is based on a presentation given to the Leasehold Forum in November 2012.

DEVELOPMENT VALUE– CALCULATIONS

Example 1:

Tenant has planning permission for a straightforward basement extension.

Amount due to freeholder under paragraph 3 of Schedule 6		
Development value		£100,000
No discount for risk		
Deferred 45 years at 5%	0.1113	
Amount due to the freeholder		£11,129.65
Marriage value		
Value of being able to carry out the development on completion		£100,000
less		
Value of being able to carry out the development at term		£11,129.65
Marriage value		£88,870.35
Landlord's share of MV 50%	0.5	£44,43517

Example 2:

As above, but requiring freeholder's permission. No marriage value, but hope value could be awarded.

Additional sum due to freeholder under paragraph 3 of Schedule 6		
Development value		£100,000
No discount for risk		
Deferred 90 years at 5%	0.01238	
Amount due to the freeholder		£1,238
Hope value under paragraph 3 of Schedule 6		
Value of being able to carry out the development on completion		£100,000
less		
Value of being able to carry out the development at term	£1,238	
Marriage value	£98,762	
Landlord's share of MV 50%	0.5	£49,381
Discount by 10%	0.9	£44,442.9

Example 3:

Two terraced houses (no.s 12 and 14). No. 12 is the subject of collective enfranchisement. Evidence shows houses worth more knocked together, but doubt over planning permission.

Amount due to freeholder under paragraph 5 (2) of Schedule 6		
Development value of 12 & 14 Tanfield Court		£100,000
Discount for risk, say, 60%	0.4	£40,000
Deferred 45 years at 5%	0.1113	
Amount due to the freeholder		£4,452

HAVE YOU OWNED YOUR FLAT LONG ENOUGH FOR A LEASE EXTENSION?

Alan Edwards says watch out - or you could be paying more than you need to.

The Leasehold Reform Housing and Urban Development Act 1993 ("the 93 Act") introduced not only the right of collective enfranchisement, but also of an individual lease extension in relation to individual flats. The right of a lessee to extend their lease was conceived by Parliament to be exercised by lessees where they were unable for some reason to collectively enfranchise. Having said that, it is possible to claim a lease extension, and then to join in a subsequent collective enfranchisement.

As originally enacted the Act contained a residence qualification. That condition was repealed by the Commonhold and Leasehold Reform Act 2002 ("the 2002 Act") which substituted a two-year ownership qualifying period calculated from the date that the initial notice is served. Section 22 (1) of the Land Registration Act 1925,and case law has established the period of ownership begins to run from the date the lessee is registered as the proprietor of the flat at HM Land Registry.

Section 128 of the 2002 Act also provided that no marriage value is payable where the length of the unexpired term of the lease exceeds 80 years at the time the initial notice requiring the lease extension is served. This change has had a profound practical effect on dealing with the sale and purchase of leases, as by far the greatest valuation element is attributed to marriage value.

If a lessee is selling a flat and the unexpired residue of the term is nearing 80 years, then the buyer will be aware that at the point the unexpired residue of the lease falls to eighty years or less a much more substantial premium will be payable for a lease extension than would otherwise be the case. The buyer will be faced with waiting for the two-year qualification period to expire before being able to acquire a lease extension by which time the unexpired residue of the term will have fallen below 80 years.

This dilemma can be resolved by the seller, serving an initial notice, whilst the lease has more than 80 years to run, and then assigning the benefit of that notice, simultaneously with the assignment of the existing leases, to the buyer (section 43 (3))of the 1993 Act. Because the date of the valuation for the purposes of the Act is the date when the initial notice is served, marriage value is not payable even though after the date of the assignment the unexpired residue of the term has fallen below 80 years.

Whilst the above is a useful procedure for both seller and buyer, care has to be taken to ensure the documentation is compliant with the legislation. If not, the buyer could end up in a position of having to wait for the two year ownership period to expire before another notice is served by which time marriage value could be payable.

Alan Edwards is Senior Partner at Alan Edwards & Co solicitors.

LEASE EXTENSIONS — MAKE IT A DATE!

Caroline Anstis gives a useful reminder of some important dates

For professionals advising regularly in this technical area of law, the lease extension process may seem straightforward. However, the legislation is littered with onerous deadlines, some of which can have very serious consequences if missed.

Here is a list of the top ten dates not to stumble on…

2 YEAR OWNERSHIP

before a claim can be initiated, a tenant must have accrued the requisite 2 year ownership period. This is taken from the date of registration at the Land Registry.

DON'T FORGET THE 80 YEAR RULE!

The need for urgent action will arise if the unexpired term of the lease is approaching 80 years. Once a lease dips below this, marriage value is incorporated into the valuation which, in simple terms will increase the premium.

DEADLINE FOR COUNTER NOTICE

following service of the Notice of Claim, the landlord must be given at least 2 months in which to respond. It is always prudent to add a further 2 weeks to allow a little breathing space.

DEPOSIT

the landlord is at liberty to demand a 10% deposit. Although there is no immediate sanction, this should be paid within 14 days of any demand.

DEDUCTION OF TITLE

this must be requested by the landlord within 21 days of service of the Notice of Claim and thereafter, although no immediate sanction, it should be supplied by the tenant within 21 days of the request.

NO COUNTER NOTICE?

An application must be made to the Court within 6 months of the Counter Notice deadline or the opportunity will be lost.

IF TERMS CANNOT BE AGREED

an application can be made to the Leasehold Valuation Tribunal for a determination. This application cannot be made any earlier than 2 months from the date of the Counter Notice but the opportunity will be lost if it is not made within 6 months of this date.

THE "APPROPRIATE PERIOD"

following agreement/ determination of terms, the following timetable applies - known as the 'appropriate period':

- The landlord must prepare the lease within 14 days of terms being agreed/determined
- The tenant has 14 days to respond
- The landlord has a further 14 days to re-amend or is deemed to accept the tenant's amendments

COMPLETION

If the lease is not completed by the end of the appropriate period, either party can apply to the Court. This application must be made within 2 months of the end of the appropriate period or again, the opportunity will be lost.

WITHDRAWAL

If a Notice of Claim is withdrawn/deemed withdrawn, no further notice can be given for a period of 12 months. This could have a significant impact on the premium!

With the above in mind, it is imperative that both landlords and tenants seek advice from a specialist to avoid falling foul of these nasty and often costly, trip wires.

Caroline Anstis is a Solicitor at PSW.

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THE PROPERTY GROUP

The Property Group "headed by Philip Rainey QC" contains many individuals ranked in Chambers UK and Legal 500 and includes the authors of "Leasehold Enfranchisement Explained" and "Service Charges and Management: Law and Practice (2nd Edition)". Chambers UK 2012 gives the Property Group at Tanfield the following plaudits:

Legal 500 2012 says:

"Tanfield Chambers houses a particularly strong residential practice with expertise in enfranchisement and service charge disputes."

Chambers UK 2013 says:

"Solicitors appreciate that the set is "much more approachable than other chambers, and has people who tend to be team players."

and

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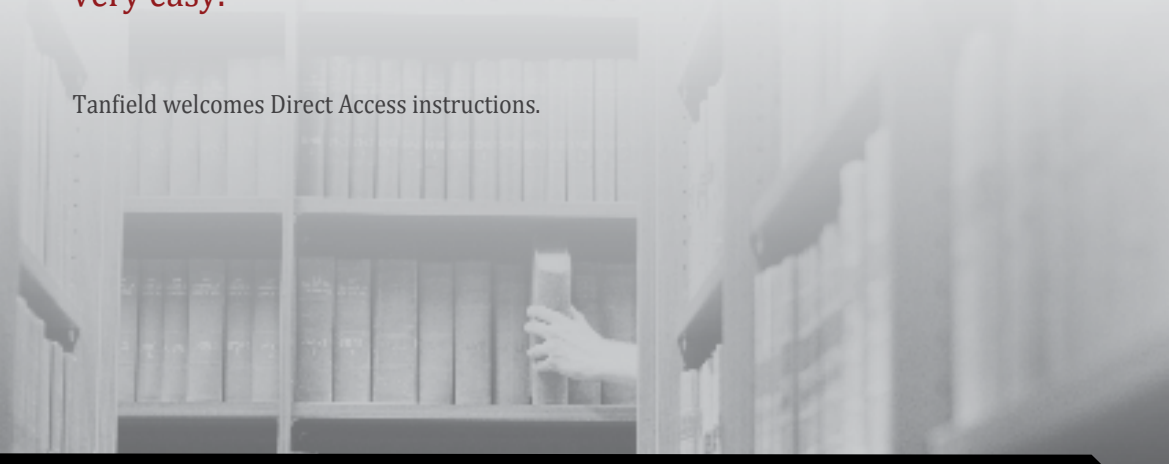

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