SYMINGTON ELVERY

Chartered Valuation Surveyors
and Property Consultants

12 St George Street London W1S 2FB
Tel +44 (0)20 3324 0360
info@symington-elvery.co.uk
www.symington-elvery.co.uk

With an unexpected vote to leave, many will anticipate further short term price reductions within the Prime Central London market, and it is my belief that, whilst this is likely to be the case, there will be a relatively short window before market conditions recover. Nevertheless, this will offer an opportunity for those owners of short, mid or even long leases to extend at a potentially advantageous price. A lease extension premium, it goes without saying, is interlinked with the value of the relevant flat and that gets fixed at the date when the claim is made. It is also my belief that extending a lease now could be potentially advantageous, prior to potential changes in valuation methodology which could impact significantly on any lease extension premium.

"Relativity" is the term used by enfranchisement practitioners with reference to the value of the existing lease of a property in relation to the freehold value. For purposes of the Marriage Value calculation, which is part of the lease extension premium in cases where there are less than 80 years remaining on the lease, the existing lease value is assessed on the hypothetical assumption that the provisions of the Leasehold Reform, Housing and Development Act 1993 (as amended) do not apply i.e. they do not have a statutory right to extend their lease. As the Act has been in place for over twenty years, evidence is increasingly hard to find and valuers, therefore, have regard to various graphs of relativity prepared by surveying firms, or look at "real world" sales and make appropriate adjustments to reflect the value of the right to extend. A new way of examining this referred to as "Hedonic Regression" was raised by Pathenia which involved the examination of thousands of sales that took place in the pre-1993 world. This research was largely beneficial for tenants as it supported higher values (for most lease lengths) than those depicted on the generally accepted relativity graphs (the higher the existing lease value the lower the Marriage Value and hence the premium). As a consequence, numerous cases were heard before the Tribunal with respect to relativity.

Most recently, in the Lands Chamber decision with respect to The Trustees of the Sloane Stanley Estate vs. Mundy, the Tribunal stated that the Gerald Eve Graph of Relativity (the "industry standard" to landlords) was the most reliable and that practitioners should defer to this and open market sales evidence with appropriate deductions for the value of Act rights, and use whichever is the lowest. This is not particularly beneficial for tenants and does have some impact on the lease extension premium, albeit it is arguably not too horrific. A hypothetical £2,000,000 flat on a 35 year lease, with a Ground Rent of £100, would have cost £543,000 to extend if an average of the Graphs of Relativity were to be employed, the previously generally accepted approach, whereas this now increases to £560,000 employing the Gerald Eve Graph.

It is my opinion that, given that very favourable decision at the Lands Chamber, with respect to relativity, Landlords may now turn their attention to the Deferment Rate. The Deferment Rate is the discount rate to assess the current value, at the valuation date, of the right to vacant possession of the flat at the end of the term. The Deferment Rate has been set at 4.75% for houses and 5% for flats since the case of Earl Cadogan vs. Sportelli in 2006. The rate was derived from obtaining a risk free rate which, in Sportelli, was derived from index linked yields plus a risk premium, reflecting the risks specific to investments in long reversions, such as volatility, illiquidity and deterioration, less a real growth rate, reflecting a long term growth in house prices. Various unsuccessful appeals have been made seeking to lower this, most notably in the case of 19-22 Onslow Gardens in 2012, by The Wellcome Trust. It is true that we live in a different world to 2006 and arguably, 2% would now be seen as a good rate of return rather than the risk free rate. A reduction in the Deferment Rate could have much more significant impact on the premium for the tenant. In my previous example, a reduction in the Deferment Rate to 3.5% from 5% increases the premium, in the hypothetical case above, by over £100,000. The impact becomes much more marked where leases have more than 80 years remaining, owing to the length of the reversion. There are numerous flats held on 89 year leases in and around Egerton Gardens, Pont Street and Lennox Gardens, which have previously been extended under the 1993 Act. There is a perception in the market that extending the leases on these flats is merely a formality and that the premium will be modest. An 89 year lease of a £2,000,000 flat, where the Ground Rent is set at a peppercorn, would currently cost in the region of £25,600 to extend (or just over 1% of the freehold value). This is based on the accepted Deferment Rate of 5%. If the Deferment Rate reduces, this premium increases to approximately £89,400.

I would, therefore, urge those with short leases to think about extending, and capitalising on a subdued market at a deferment rate of 5%. Those that have got long leases with between 80 and, say, 95 years unexpired, who intend to keep their properties, will need to extend before the leases drop below 80 years anyway prior to Marriage Value becoming payable at which time, the premium payable normally increases very substantially. Given the potential of a successful appeal with respect to the Deferment Rate, it would seem to me that it is not worth the risk of waiting.