Leasehold home ownership: buying your freehold or extending your lease

Report on options to reduce the price payable
Leasehold home ownership: buying your freehold or extending your lease

Report on options to reduce the price payable

Presented to Parliament pursuant to section 3(2) of the Law Commissions Act 1965

Ordered by the House of Commons to be printed on 8 January 2020.

HC 13
The Law Commission

The Law Commission was set up by the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

The Law Commissioners are:

- The Right Honourable Lord Justice Green, Chairman
- Professor Sarah Green
- Professor Nick Hopkins
- Professor Penney Lewis
- Nicholas Paines QC

The Chief Executive of the Law Commission is Phil Golding.

The Law Commission is located at 1st Floor, Tower, 52 Queen Anne's Gate, London SW1H 9AG.

Professor Sarah Green and Professor Penney Lewis were appointed Law Commissioners on 1 January 2020. The terms of this report were agreed on 12 November 2019 when Professor David Ormerod QC and Stephen Lewis were Law Commissioners.

The text of this report is available on the Law Commission's website at http://www.lawcom.gov.uk.

All websites footnoted in this report were last visited on 16 December 2019.
# Table of Contents

Glossary .......................................................... vii
Summary .......................................................... 1 - 31

## CHAPTER 1: INTRODUCTION ........................................ 1

This Report ......................................................... 1
What is leasehold ownership? ............................. 2
What are enfranchisement rights? ......................... 5
What are premiums? ............................................ 5
  - The views and opposing interests of landlords and leaseholders .......................... 6
  - Views on the fairness of enfranchisement premiums ........................................... 7
  - The difference between premiums and professional costs ...................................... 8
  - Two broad methods of calculating premiums .................................................... 9

Our project ......................................................... 9
Our Terms of Reference: options for reducing premiums, not recommendations ............ 10
Sufficient compensation and human rights ................. 11
  - Leaseholders' human rights ................................................................................. 12
  - Landlords' human rights .................................................................................... 12

The options for reducing premiums in this report ........ 14
The Consultation Paper and consultation events .......... 15
  - How we have dealt with consultation responses ............................................... 15

Issues beyond our Terms of Reference ...................... 17
Welsh devolution .................................................... 18
Structure of this Report ......................................... 19
Summary of the options for reducing premiums in this Report .................................. 20
Publications accompanying this Report .................... 21
Acknowledgements ............................................... 21
The project team .................................................... 21

## CHAPTER 2: CALCULATING PREMIUMS UNDER THE CURRENT LAW .......................... 23

Introduction ......................................................... 23
(A): The current valuation methodology ................. 26
  (1) The “term” .................................................... 27
  (2) The “reversion” ............................................. 31
  (3) Marriage value ............................................. 33

Summary .......................................................... 38
CHAPTER 6: “SUB-OPTIONS” FOR A NEW SCHEME TO REDUCE PREMIUMS

Introduction
Overview of the sub-options set out in this chapter
Reform to elements that would (or could) reduce premiums

Sub-option (1): Prescribing rates
  What do we mean by prescription of rates?
  The benefits of prescribing rates (at, or below, market levels)
  The benefits of prescribing rates below market levels
  Consultation responses concerning prescription of rates
  A culture change: moving from individual tailored valuations to general valuations
  Prescription of capitalisation rates
  Prescription of deferment rates
  Prescription of relativity (or the no-Act deduction)
  Compatibility with A1P1 of prescribing rates
  Conclusion: options for Government relating to prescription of rates
  Can FHVP values be prescribed?

Sub-option (2): Treatment of ground rent
  The significance of ground rents for landlords and leaseholders
  The Consultation Paper
  Consultees’ views
  Compatibility with A1P1 of a cap on ground rent in the enfranchisement valuation
  Conclusion: options for Government

Sub-option (3): Development value
  The Consultation Paper
  Consultees’ views
  Alternative mechanisms to provide an election restricting development
  Compatibility with A1P1 of enabling leaseholders to elect to take a restriction on development
  Conclusion: options for Government
Sub-option (4): Differential pricing for different types of leaseholder
The Consultation Paper
How can a distinction be drawn in practice?
Consultees’ views on differential pricing
Compatibility with A1P1 of differential pricing for different types of leaseholder
Conclusion: options for Government
Reform to elements that would, by themselves, increase premiums
Sub-option (5): 80-year cut-off in respect of marriage value
The Consultation Paper
Consultees’ views
Conclusion: options for Government
Sub-option (6): Discount for leaseholders’ improvements
The Consultation Paper
Consultees’ views
Conclusion: options for Government
Sub-option (7): Discount for the risk of holding over
Current position
Consultees’ views
Conclusion: options for Government
Conclusion

CHAPTER 7: WORKING TOWARDS AN ONLINE CALCULATOR
Introduction
The benefits of an online calculator
Reducing the variables by prescribing rates
The remaining variable: FHVP value
How is the FHVP value relevant to the calculation of enfranchisement premiums?
Conclusion
The status of an online calculator
Consultation responses
Consultees in favour of an online calculator
Consultees opposed to an online calculator
Conclusion
How should an online calculator be established?
Conclusion

CHAPTER 8: COMBINING THE NEW VALUATION “SCHEMES” WITH THE DIFFERENT “SUB-OPTIONS” FOR REFORM
Introduction
Summary of the schemes and sub-options
**Glossary**

“1967 Act”: the Leasehold Reform Act 1967, which gives leaseholders of houses the right to buy their freehold or extend their lease.

“1993 Act”: the Leasehold Reform, Housing and Urban Development Act 1993, which gives leaseholders of flats (a) the right to extend their lease, or (b) the right, acting with the other leaseholders in their building, to purchase the freehold of their block.

“2002 Act”: the Commonhold and Leasehold Reform Act 2002, which made various changes to the enfranchisement regime.

“A1P1”: Article 1 of the First Protocol to the ECHR (see below), which provides for the peaceful enjoyment of property.

“Assumption”: when assessing the market value of an asset, it is necessary to make “assumptions” about the market in which the asset is being sold or about the nature of the asset. For example, it is assumed that the leaseholder has complied with any repairing obligation in the lease.

“Capitalisation/capitalisation rate”: “capitalisation” refers to the calculation of a capital sum which reflects the right to receive income (such as ground rent) in the future. The “capitalisation rate” is the rate of return applied to calculate a capital sum that reflects the value of such an income stream. It is derived from market evidence. See paragraph 2.19.

“Collective enfranchisement”: the statutory right for leaseholders of flats, acting with the other leaseholders in their building, to purchase the freehold of their block.

“Compensation”: see “premium”.


“Decapitalisation”: the process of deriving an annual income which is equivalent to a given capital sum. See paragraph 9.17.

“Deferment rate”: the annual discount applied, on a compound basis, to reflect the fact that money due to be received in the future (assessed at current prices) will instead be received now. In this context, a deferment rate is used to ascertain the present value of an asset that consists of the right to have a property back at the end of the lease. See paragraph 2.34.


“Enfranchisement rights”: leaseholders have a statutory right to extend their lease. In addition, leaseholders of houses have a statutory right to purchase their freehold, and leaseholders of flats have a statutory right, acting with the other leaseholders in their building, to purchase the freehold of their block (“collective enfranchisement”).
“Freehold ownership”: freehold ownership is property ownership that lasts forever, and which generally gives fairly extensive control of the property.

“Freehold vacant possession (FHVP) value”: the amount that a property is worth held on a freehold basis and not subject to any leasehold interests. See paragraph 2.32.

“Find R test”: the test relies on a formula set out in section 1(1)(a)(ii) of the Leasehold Reform Act 1967, the purpose of which is to calculate, if the premium payable upon the grant of a lease were instead paid as an annual rent, what that rent would be. The test is used in section 1(1)(a)(ii) to determine whether a lease granted on or after 1 April 1990 (and not pursuant to a contract made before that date) qualifies for a valuation under the “original valuation basis” (under section 9(1) of the Leasehold Reform Act 1967) and, in that section, the outcome (“R”) cannot exceed £25,000 on the date that the lease was entered into or contracted for. See paragraph 9.91 onwards.

“Ground rent”: a regular payment which a leaseholder is required by his or her lease to pay to the landlord. Ground rents can be “fixed” (for instance, £300 per annum), subject to a simple review (for example, increasing by £50 per annum every 25 years), or subject to a “dynamic” review (for instance, increasing in line with the Retail Prices Index).

“Hope value”: a deferred form of marriage value (see below). If a freehold interest is sold to someone other than the leaseholder, marriage value will not be realised as a result of that sale. However, the purchaser might “hope” that they will sell the freehold to the leaseholder in the future, which will realise marriage value. The purchaser may therefore pay an additional amount now (“hope value”) to reflect that future possibility. In the context of collective enfranchisements, hope value may be payable in respect of non-participating flats, to reflect the fact that the leases of those flats may be extended (at a premium) in the future. See paragraph 2.51.

“Landlord”: a person who owns an interest in property out of which a lease has been granted. A landlord may be either the freeholder of the property, or hold a leasehold interest in the property himself or herself.

“Lease”: the legal device (usually a written document) that grants a person a leasehold interest in a property and sets out the rights and responsibilities of the leaseholder and landlord. A leasehold interest is a form of property ownership (see “leasehold ownership”).

“Leasehold ownership”: leasehold ownership of property is time-limited ownership (for example, ownership of a 99-year lease), and control of the property is shared with, and limited by, the landlord.

“Leaseholder”: a person who owns property on a long lease.

“Mainstream valuation basis”: the basis for valuing the enfranchisement premium for all flats, and for those houses which do not fall within the “Original valuation basis” (see below). It is based on an assessment of the market value of the landlord’s interest. See paragraphs 1.30 and 2.8 onwards.
“Market value”: the amount that an asset is worth if sold in the open market. See paragraphs 2.10 and 5.80.

“Marriage value”: the additional value that is gained when the landlord’s and leaseholder’s separate interests are “married” into single ownership. It is the difference between:

(1) the value of the freehold in single ownership; and

(2) the value of both (a) the freehold interest and (b) the leasehold interest in separate ownership.

The value of (1) is often more than (2). Marriage value is “realised” or “released” by an enfranchisement claim because the freehold and leasehold interests, previously in separate ownership, are now in single ownership. See paragraph 2.40 onwards.

“Modern ground rent”: the rent determined under section 15 of the Leasehold Reform Act 1967, payable during the additional term of a 50-year lease extension of a house (under the current law). It is calculated by valuing the “site”, and then decapitalising that value. See paragraphs 2.5 and 9.15.

“No-Act deduction”: when calculating marriage value, it is necessary to establish the value of the existing lease, on the assumption that the leaseholder’s statutory enfranchisement right does not exist. Valuers commonly value the existing lease by finding the real-world value of a comparable short lease, and then deducting from this the estimated value of the benefit of enfranchisement rights. This approach is also referred to as a “deduction for Act rights”. See paragraph 2.44 onwards.

“Original valuation basis”: the basis for valuing the freehold of a house under section 9(1) of the Leasehold Reform Act 1967, based largely on an assessment of the market value of the land on which the house is situated, but not the value of the house itself. It applies to houses which fall below certain financial limits. It does not apply to any flats. See paragraph 1.30 onwards and Chapter 9.

“Peppercorn rent”: many long leases specify an annual ground rent of a peppercorn. Strictly, the landlord in these cases could require the leaseholder to provide him or her with a peppercorn annually, but invariably this is not demanded. A peppercorn rent is used in circumstances where it is intended that there should be no substantive rent payable. Under the current law, any lease extension of a lease of a flat under the 1993 Act must be granted at a peppercorn rent.

“Premium”: the premium is the sum a leaseholder or nominee purchaser must pay to the landlord(s) in order to exercise enfranchisement rights, namely in order to obtain a lease extension or to acquire the freehold of property. The premium is also referred to as the “price” or “compensation”. In other contexts, "premium" is used to describe the capital sum paid by a leaseholder when they purchase a lease of a property: it is the sale price for the property. See para 6.148.

“Price”: see “premium”. 
“Prime Central London”: Savills Residential Research produce a Prime London Index which is designed to reflect the price movements of prime property in London. The Index is divided into five areas: Central, North West, North & East, South West and West. The “Prime Central London” Index includes Notting Hill, Kensington, Chelsea, Knightsbridge, Marylebone, Mayfair, Westminster and Pimlico. Whilst the term Prime Central London (“PCL”) is not necessarily used with precision, it generally refers to these areas.

“Rateable Value” or “Domestic rateable value”: a value attributed to a property, based on an assessment of the annual rental value of the property. Part of a system of local taxation that was used by local authorities for domestic (residential) properties between 1967 and 1990 (and which was a predecessor to council tax). Assessments of rateable values were carried out by the District Valuer's Office. Rateable values for domestic properties were abolished on 1 April 1990 when a new scheme of local taxation was introduced.

“Relativity”: the relative value of (a) a leasehold interest in a property, and (b) the freehold interest of that same property with vacant possession (the FHVP value), expressed as a percentage. See paragraph 2.44 onwards.

“Reversion”: we use “the reversion” to refer to the value of the right to have the property back when the lease expires (sometimes referred as the right to have “vacant possession”). See paragraph 2.28 onwards.

“Schemes”: we present three overall “schemes” as options for a reformed valuation methodology in Chapter 5. In Chapter 8, we explain how the adoption of one of the schemes can be combined with the various “sub-options” for reform discussed in Chapter 6.

“Section 9(1) valuation basis”: see “Original valuation basis”.

“Sub-options”: we present various “sub-options” for reform in Chapter 6. They are individual component parts of calculating enfranchisement premiums, which could feature in one or more of the overall valuation “schemes”. In Chapter 8, we explain how the sub-options could be combined with one of the new valuation schemes discussed in Chapter 5.

“Sunset period”: a temporary period of time following the introduction of new legislation (where such new legislation is intended to replace existing legislation), during which the existing law remains in force before being abolished. A sunset period is generally intended to assist those whose rights would be negatively affected by the introduction of the new legislation by giving them a period of time to exercise their rights under the existing law before it is abolished.

“Site value”: under the Leasehold Reform Act 1967, the value of the land on which a house is situated, not including the value of that house. Site value is decapitalised to calculate the modern ground rent payable during the additional term of a lease extension. See paragraph 9.15.

“Term”: we use “the term” to refer to the value of the right of the landlord to receive the ground rent for the duration of the lease. See paragraph 2.12 onwards.
“Term and reversion”: we use “term and reversion” to refer to the value of the right of the landlord to receive the ground rent for the duration of the lease (“the term”) and the right of the landlord to have the property back when the lease expires (“the reversion”). See paragraphs 2.12 and 2.28 respectively.

“Tribunal”: the First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal in Wales.

“Unexpired term”: the remaining amount of time left until the end date specified in a lease. A lease granted for a period of 50 years will, after 10 years, have an unexpired term of 40 years.

“Valuation”: the process of calculating the premium by putting a financial value on the interest the landlord has that will be acquired by the leaseholder.

“White knight”: a third party who contributes to the premium payable on a collective enfranchisement in respect of the non-participating leaseholders’ share of that premium.

“Years’ purchase”: years’ purchase is tied to inflation, and the fact that, in general, money will buy less in the future than it does now. It is a multiplier which is calculated through the setting of a yield (or other variable) and a number of years (for instance, until the expiry of a lease). See paragraph 2.16.

“Yield rate”: yield rate has the same meaning as “capitalisation rate”.
LEASEHOLD HOME OWNERSHIP: BUYING YOUR FREEHOLD OR EXTENDING YOUR LEASE

Report on options to reduce the price payable

Summary
Introduction

Leasehold enfranchisement is the process for people who own property on a long lease (“leaseholders”) to extend the lease, or buy the freehold. In order to exercise enfranchisement rights, leaseholders must pay a sum of money (“a premium”) to their landlord.

This paper summarises our “Report on options to reduce the price payable”, published on 9 January 2020 (“the Report”), and available at www.lawcom.gov.uk/project/leasehold-enfranchisement/. The Report concerns how premiums are calculated.

The Report follows our consultation on wide-ranging reforms to the enfranchisement regime. Our Consultation Paper is available at the same address.

Our Terms of Reference, agreed with Government, asked us:

“to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests” (emphasis added).

In accordance with our Terms of Reference, therefore, in the Report:

1. we set out options for reducing premiums and for simplifying the way in which premiums are calculated; but
2. we do not make a recommendation as to how premiums should be calculated. That is a not just a legal question: it involves considerations of law, valuation, social policy, and political judgement, and is therefore for Government and ultimately Parliament to decide.

The Report enables Government and Parliament to decide how premiums should be calculated, informed by the consultation responses that we received and by our own expertise and analysis.

In the Report, we set out three alternative options for a new regime to calculate premiums. Within each of those three schemes, there is a series of further sub-options for reform. In this Summary, we explain those three schemes, and the sub-options, for reform. At each stage, we explain which leaseholders would benefit from the reforms. A diagram representing the schemes and sub-options, and the relationship between them, is then provided at page 23.
Depending on which options for reform are pursued, it would be possible to create an online calculator for the calculation of premiums. Whilst valuation is complex, it does not have to be complex for the user. An online calculator would be simple for leaseholders to use, and would provide them with certainty about what their enfranchisement premium will be.

Valuation is a technical subject, but we have tried to make this Summary, and the Report, as accessible as possible. We have included a glossary at the end of this Summary.

In England and Wales, property is currently almost always owned on either a freehold or a leasehold basis.

1. Freehold is ownership that lasts forever, and generally gives fairly extensive control of the property.
2. Leasehold provides time-limited ownership (for example, a 99-year lease), and control of the property is shared with, and limited by, the freehold owner (that is, the landlord).

Our project concerns leasehold ownership.
The purpose of a leasehold home

For landlords
- Income generation
- Lease extension payments
- Ground rent payments
- Administrative fees from leaseholders

For leaseholders
- Home owner
- Capital investment
- Ground rent payments
- Lease extension payments
- Administrative fees from leaseholders
- Private and family life
- Safety and security
- Capital investment

What are enfranchisement rights?
Legislation has been enacted that gives leaseholders “enfranchisement rights”.

Lease extension
Leaseholders have a right to extend their lease (“the right to a lease extension”), which provides them with longer-term security in their home. Leaseholders’ security in their home, and the value of their asset, is far better protected if, as the current law allows, they can extend, say, a 60-year lease to 150 years.

Freehold purchase
Leaseholders of houses have a right to purchase their freehold, and leaseholders of flats have a right, acting with the other leaseholders in their building, to purchase the freehold of their block. Freehold acquisition provides leaseholders with the same advantages as a lease extension (namely, security in their home and protecting the value of their asset), but also allows leaseholders to gain control of their property from an external landlord.
What are premiums? *(see Chapter 2 of the Report)*

The result of an enfranchisement claim is that the leaseholder acquires from the landlord an enhanced interest in their property. Put another way, an enfranchisement claim involves the transfer of a property right (a longer lease or the freehold) from the landlord to the leaseholder.

Leaseholders must make a payment to their landlord to reflect the value of the enhanced interest that they acquire from the landlord. We use the term “premium” to describe this payment, but it is sometimes also referred to as a “price” or “compensation”.

An example: why must leaseholders pay a premium?

A leaseholder has 60 years remaining on his or her lease, and is required by the lease to pay the landlord a “ground rent” of £200 per year.

The landlord is entitled to have the property back in 60 years’ time, and to receive the ground rent each year.

Result of an enfranchisement claim under the current law

Flats

The lease is extended by 90 years, so the landlord will not now be entitled to have the flat back for 150 years. The ground rent is reduced to nothing, so the landlord will no longer be entitled to the ground rent of £200 per year for the next 60 years.

Houses

The leaseholder acquires the freehold, so the landlord will not now be entitled to have the house back at all and will no longer be entitled to the ground rent of £200 per year for the next 60 years.

Requirement to pay a premium

The landlord’s entitlement under the lease, which is lost on enfranchisement, is valuable to the landlord. Equally, the enhanced interest acquired by the leaseholder through the enfranchisement claim is valuable to the leaseholder.

Leaseholders must make a payment to their landlord to reflect the value of the enhanced interest that they acquire from the landlord. We use the term “premium” to describe this payment, but it is sometimes also referred to as a “price” or “compensation”.

---

Leasehold home ownership: buying your freehold or extending your lease – a summary
Calculating the premium is known as “valuation” as it involves putting a financial value on the interest the landlord has that will be acquired by the leaseholder. Broadly speaking, enfranchisement premiums are intended to reflect the “market value” of the landlord’s asset – which we discuss further below. The market value is the amount that an asset is worth if sold in the open market.

There are two main bases of valuation:

1. The “mainstream valuation basis” is based on an assessment of the market value of the landlord’s interest. It applies to all flats and many houses.

2. The “original valuation basis” includes an assessment of the market value of the land on which the house is situated, but not the value of the house itself, and results in lower premiums for leaseholders. It applies to houses (not flats) which fall below certain financial limits.

We discuss the current law and the methods used to calculate premiums in Chapter 2 of the Report. We deal specifically with the original valuation basis in Chapter 9 of the Report.

Throughout the Report, we refer to a number of example enfranchisement claims. We use these examples to demonstrate how premiums are currently calculated under the “mainstream valuation basis”, as well as to show the impact that our options for reform may have on those premiums. In this Summary, we include just one of the examples from the Report (which we call House A in this Summary – and which is “House 2” in the Report): the purchase of the freehold of a house, worth £250,000 and with 76 years remaining on the lease.

<table>
<thead>
<tr>
<th>House A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value on a freehold basis: £250,000</td>
</tr>
<tr>
<td>Valuation date: 2019</td>
</tr>
<tr>
<td>Details of existing lease:</td>
</tr>
<tr>
<td>Granted in 1995</td>
</tr>
<tr>
<td>for 100 years</td>
</tr>
<tr>
<td>Unexpired term: 76 years</td>
</tr>
<tr>
<td>Value of lease: £226,250</td>
</tr>
<tr>
<td>Ground rent: £50 a year, increasing by £50 every 25 years:</td>
</tr>
<tr>
<td>– £50 per annum from 1995</td>
</tr>
<tr>
<td>– £100 per annum from 2020</td>
</tr>
<tr>
<td>– £150 per annum from 2045</td>
</tr>
<tr>
<td>– £200 per annum from 2070</td>
</tr>
</tbody>
</table>

The enfranchisement premium would comprise three elements:

1. the value of the right to receive the ground rent over the next 76 years, which is referred to as “the term” +

2. the value of the right to have the property back when the lease expires, which is referred to as “the reversion” +

3. half of the “marriage value”, which is an additional payment to reflect the fact that the value of owning the freehold outright is worth more than the sum of the freehold and leasehold interests in separate ownership. (We discuss marriage value, and the related concept of “hope value”, further below.)

The exact enfranchisement premium for House A would depend on various factors. In particular, each of the three elements of the premium is calculated by using certain “rates” which will vary from case to case. We have given indicative rates in our worked examples, and the result of using those rates is that the premium that the leaseholder would have to pay in order to acquire the freehold of House A is £16,453.
House A

The total premium is:
the term (£1,806)
+ the reversion (£7,349)
+ the payable share (50%) of marriage value (£7,298)
= £16,453

In Appendix 3 to the Report, we explain in detail how each element (the term, the reversion, and the payable share of marriage value) is calculated under the current valuation methodology.

We refer back to House A when we discuss our options for reform below.

```
What is “marriage value” and “hope value”?  
The combined value of the leaseholder’s interest and the landlord’s interest in a property is often less than the value of those interests if they were held by the same person.

---

**In separate ownership**

The leaseholder’s interest is worth £226,250.
The landlord’s interest (which is the value of “the term” and “the reversion”) is worth £9,155.
So in separate ownership, the lease and the freehold are worth a total of £235,405.

---

**In single ownership**

The freehold to House A is worth £250,000.
So if the lease and freehold were owned by the same person, they would be worth £250,000.

---

The difference between those two figures is the “marriage value”, here £14,595.
When the leaseholder acquires the freehold, that marriage value is “realised” or “released” because the leaseholder now owns a house worth £250,000.

Where the lease has 80 years or less to run, the legislation requires the leaseholder to pay half of the marriage value to the landlord. Where the lease has more than 80 years to run, the legislation states that the leaseholder does not have to pay any marriage value to the landlord.

“Hope value” is a deferred form of marriage value. If the freehold is sold to someone other than the leaseholder, marriage value will not be realised as a result of that sale. However, the purchaser might “hope” that they will sell the freehold to the leaseholder in the future, which will realise marriage value. The purchaser may therefore pay an additional amount now to reflect that future possibility. That additional amount is “hope value”.

Hope value is always less than marriage value. A purchaser would not pay the full marriage value because the marriage value may not in fact ever be realised (if the lease simply runs its course and expires) or the marriage value may not be realised for a long time.

An individual leaseholder never pays both marriage value and hope value; only one of these elements of the premium is ever relevant to calculating the premium in an enfranchisement claim.
```
Market value and the role of assumptions

Enfranchisement premiums under the “mainstream valuation basis” (and, to some extent, under the “original valuation basis”) are intended to reflect the “market value” of the landlord’s asset. The valuation of any asset, whether in the context of an enfranchisement claim or in any other context, involves various “assumptions” being made. Assumptions are made about the market in which the asset is being sold or about the nature of the asset that is being sold. For example, in the calculation of enfranchisement premiums, it is assumed that the leaseholder has complied with any repairing obligation in the lease – otherwise a leaseholder would benefit from a lower premium by allowing the property to get into a state of disrepair in breach of the repairing obligation.

Under the mainstream valuation basis, there is an assumption (which reflects the reality of the transaction) that the leaseholder is the purchaser of the asset. Since the leaseholder is the purchaser, the enfranchisement transaction will result in the marriage value being realised. The legislation therefore requires the marriage value to be split between the landlord and leaseholder (where the lease has 80 years or less to run) – so the leaseholder must pay half of the marriage value to the landlord. That split is based on the view that – in a negotiation – the landlord and leaseholder would agree to split the marriage value between themselves equally.

It is possible to make different hypothetical assumptions about the transaction being valued: for example, that the leaseholder is or is not the purchaser (known as “being in the market”) and/or that the leaseholder will or will not be in the market at some future time.

As we go on to explore below when discussing our options for reform, the assumption about the presence of the leaseholder in the market has a significant effect on the enfranchisement premium. It determines whether or not marriage value or hope value is payable.
PROBLEMS WITH THE CURRENT LAW

We explore various problems with the current law in Chapter 2 of the Report.

- Complexity
- Delays
- Artificiality
- Hypothetical valuation
- Inconsistency in the regime
- The stakes are high
- Various technical problems
- Unpredictable outcomes
- Inequality of arms
- Undesirable incentive structures
- Potentially arbitrary outcomes
- Uncertainty being used as a negotiating chip
- Inconsistency being used as a negotiating chip
REDUCING PREMIUMS

Views on the fairness of enfranchisement premiums

During our project, we have heard opposing views from landlords and leaseholders about the fairness of the requirement to pay a premium in order to enfranchise, and the level of that premium. We summarise those views in the Report. Our Terms of Reference require us to examine the options to reduce premiums, and we take that as our starting point.

A lease extension, or freehold purchase, is done against our will.

Enfranchisement involves leaseholders getting something that they, and their predecessors, have not previously paid for.

Reducing premiums would result in the arbitrary transfer of wealth from one type of investor to another.

We have a contractual entitlement to have the property back at the end of the lease, and to receive the ground rent under the lease.

Reducing premiums would reduce the income of some charities, and reduce the value of some pension funds.

Leaseholders have not acquired outright ownership of their home. They have agreed to purchase, and only paid for, a time-limited asset, with a requirement to pay ground rent. If their asset is to be enhanced, which results in a corresponding loss to the landlord, they must pay for it.

If leaseholders can take landlords’ assets, they should pay the full market value for that asset.

The sale of leases is standard, accepted and well-known practice, and the system works.
Sufficient compensation and human rights (see Chapter 1 of the Report)

The law governing human rights is highly relevant to valuation reform. Article 1 of the First Protocol ("A1P1") to the European Convention on Human Rights ("ECHR") provides for the peaceful enjoyment of property.

**Article 1 of the First Protocol ("A1P1") to the ECHR**

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. …
A1P1 and most other rights under the ECHR (“the Convention rights”) have been incorporated into English law by the Human Rights Act 1998 (“the 1998 Act”). The Convention rights therefore form part of English law, and any reforms to the enfranchisement regime that we set out, which Government seeks to implement, and which Parliament enacts, need to be compliant with the Convention rights.

The 1998 Act allows courts to declare that a provision of an Act of Parliament is incompatible with the Convention rights, and to award damages for any breach of Convention rights. In addition, a challenge can be brought in the European Court of Human Rights which can decide that there has been a breach of the Convention rights and which can make an award of compensation.

Accordingly, if legislation that reduces premiums is not compatible with the Convention rights, a challenge could be made and Government could be required to pay compensation to landlords whose rights have been infringed. The legislation is also likely to be amended in order to make it compatible with the Convention rights.

Our project, and the options for reform that we present, must therefore operate within human rights law. Some consultees asserted that any reduction in enfranchisement premiums would be unlawful under A1P1 and it is clear that any reforms will be carefully scrutinised. Given the necessity for a reformed valuation regime to be lawful under A1P1, we have obtained the independent opinion of Catherine Callaghan QC, a specialist human rights barrister, on the compliance with human rights law of our options for reducing premiums (which we refer to as “Counsel’s Opinion”). We have published Counsel’s Opinion alongside the Report, and we quote Counsel’s Opinion throughout the Report.

**Leaseholders’ human rights**

During our consultation events, and in their consultation responses, leaseholders often asked us why we were focusing on landlords’ human rights, and what consideration was being given to their own human rights.

**How are leaseholders’ human rights under the ECHR relevant? (Taken from Counsel’s Opinion)**

It is important to bear in mind that leaseholders also enjoy rights that are protected under the ECHR. Leaseholders enjoy the right to the peaceful enjoyment of their possessions under A1P1. Residential leaseholders who are owner-occupiers also benefit from the right to respect for their home under Article 8 ([Article 8 provides that “Everyone has the right to respect for his private and family life, his home and his correspondence.”](#)].

However, leasehold enfranchisement legislation does not interfere with leaseholders’ property rights under A1P1. Leaseholders’ interests are taken into account when determining the amount of compensation payable to landlords, as the exercise of assessing whether a fair balance has been struck necessarily entails balancing the interests of landlords against the interests of leaseholders, both in their own right and when considering the general interest of society.

Article 8 is not concerned with the right to own or occupy property as such. Article 8 is not engaged or violated either by the ordinary operation of a lease (which limits a leaseholder’s occupancy of the property to the term of the lease) or by requiring the leaseholder to pay for the extension of the lease or purchase the freehold to avoid that result.
The law is clear that leaseholders cannot rely on their human rights under A1P1 or Article 8 to challenge the ordinary operation of their lease, including the fact that they must make an enfranchisement claim, and that they must pay a premium to do so.

**Landlords’ human rights**

As we set out above, our Terms of Reference require us to consider valuation options that ensure “sufficient compensation is paid to landlords to reflect their legitimate property interests”. Views will invariably differ on what constitutes sufficient compensation. In legal terms, a central issue in determining whether compensation is “sufficient” is whether it is compatible with A1P1.

So landlords’ human rights do not prevent leaseholders from buying their freeholds or extending their leases against the wishes of their landlord. But they do require leaseholders to pay for the freehold or lease extension in order to justify the interference with the landlord’s property rights.

The enfranchisement premium that is paid by leaseholders to landlords is relevant when assessing the compatibility with A1P1 of any options for reform that would reduce those premiums.

**How are landlords’ human rights under A1P1 relevant? (Taken from Counsel’s Opinion)**

A1P1 protects the right to the peaceful enjoyment of possessions, and in substance guarantees the right of property. “Possessions” include real and immovable property, and therefore A1P1 protects any proprietary interest in land.

A1P1 can be invoked by any “natural or legal person” who has suffered an interference with their possessions for which the state is responsible, and can therefore be invoked not only by an individual but also by a company or other legal entity (whether based in the UK or elsewhere).

A1P1 is a qualified right. An interference with a person’s property rights can be justified where a legitimate aim is pursued by reasonably proportionate means. This involves an assessment of whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual’s rights. The payment of compensation is relevant to the fairness of the balance struck.

Legislation which permits a leaseholder to compulsorily acquire the freehold or extend the lease of a house or flat interferes with a landlord’s property rights under A1P1 and will only be lawful if the level of compensation payable to the landlord is sufficient to justify the interference with those property rights.

It is not necessary for landlords to be provided with full market value for their interest; there is some discretion within which property rights can be interfered with to achieve a legitimate aim. But generally the further away from market value the compensation is, the more difficult it is likely to be to justify the interference.

In the Report, we only put forward options for reform that are likely to be compatible with landlords’ rights under A1P1. We have not, therefore, put forward options that are unlikely to be compatible with landlords’ rights under A1P1. Our assessment of the compatibility of the options for reform that we put forward in the Report is based on Counsel’s Opinion.

**Our role (see Chapters 1 and 4 of the Report)**

As we have explained above, our task is to set out the options that are available for reducing premiums payable by leaseholders. The question of whether and how premiums should be reduced is not solely a question of law: it involves considerations of law, valuation, social policy, and political judgement. It is a question for Government, and ultimately Parliament, to decide.
We have worked within our Terms of Reference to devise, consult on, analyse, and present the options for reform that exist, taking into account the views of consultees and working within the parameters of A1P1. The Report is the culmination of our work, setting out in detail the options for reducing premiums that are available, to allow Government and Parliament to decide which option(s) to pursue.

Implementing reform

Once Government has decided how valuation should be reformed, it will then be necessary to implement that reform by means of primary legislation (an Act of Parliament). A Bill will need to be prepared, which could create a new enfranchisement regime, covering both the valuation issues included in the Report and all other issues which will be included in our forthcoming report on enfranchisement reform.

CONSULTATION PERIOD AND EVENTS

On 20 September 2018, we published a Consultation Paper setting out our provisional proposals for wide-ranging reforms to the enfranchisement regime. We asked for views on valuation reform, and made proposals for reform designed to provide a new scheme of qualifying criteria for enfranchisement rights, to enhance and improve the enfranchisement rights themselves, and to provide a new unified procedure for all claims.

Following publication of our Consultation Paper, we held various public consultation events around England and Wales in order to explain our proposals for reform, encourage discussion and debate about our proposals, gather attendees’ views and encourage people to provide written responses to the Consultation Paper. We also met with different groups of stakeholders to hear their views about reform.

In response to requests from consultees, we extended our consultation period to 7 January 2019. We received over 1,100 responses to our Consultation Paper and over 1,500 responses to our online survey about leaseholders’ experiences of the enfranchisement process.

This Summary (and the Report) only concerns valuation reform. We will subsequently publish a separate report with our recommendations for reforming all other aspects of the enfranchisement regime.

We have published the consultation responses, in so far as they relate to valuation, alongside the Report. All other consultation responses will be published alongside our forthcoming separate report.

As explained above, there were many strongly-held views about leasehold reform, from leaseholders, landlords, professionals, and others. We have taken those views – expressed to us at consultation events and in written consultation responses – into account as we have developed the options for reform that we set out in the Report, and the recommendations for reform that we will set out in our forthcoming reports.
OUR OPTIONS FOR REFORM

Our Report sets out various options for reducing premiums and for improving the enfranchisement valuation process, such as increasing certainty or reducing delays.

Overall schemes: three options (see Chapter 5 of the Report)

In the Report, we set out three alternative options for a new regime to calculate premiums: Scheme 1, Scheme 2 and Scheme 3. They would set the general framework for the reformed enfranchisement valuation regime. As we go on to explain, within each of those schemes, there is a series of further sub-options for reform.

The enfranchisement premium under all three schemes would include an amount to reflect the value of “the term” and “the reversion”. The main difference between the three schemes is whether or not the premium includes marriage value or hope value.

Technical explanation of the schemes

<table>
<thead>
<tr>
<th>Scheme 1</th>
<th>Scheme 2</th>
<th>Scheme 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Scheme 1, it is assumed that the leaseholder is never in the market. The result is that no marriage value or hope value is payable.</td>
<td>Under Scheme 2, it is assumed that the leaseholder is not now in the market but may be in the future. The result is that hope value (but not marriage value) is payable.</td>
<td>Under Scheme 3, it is assumed that the leaseholder is in the market. The result is that marriage value is payable.</td>
</tr>
</tbody>
</table>

What is the effect of the schemes?

- Under Scheme 1, the enfranchisement premium would be: Term + Reversion
- Under Scheme 2, the enfranchisement premium would be: Term + Reversion + Hope value
- Under Scheme 3, the enfranchisement premium would be: Term + Reversion + Marriage value

How do the schemes compare with the current law?

Schemes 1 and 2 would reduce enfranchisement premiums. Scheme 3 reflects the current law. But all three schemes can be used as a framework for other reforms to reduce premiums (which we discuss below).

Who would benefit from the schemes?

- All leaseholders would benefit from the schemes if they are used as the framework to implement other reforms to reduce premiums (which we discuss below).
- Leaseholders with 80 years or less to run on their lease would also benefit directly from Scheme 1 or Scheme 2 since those schemes would lead to a reduction in their enfranchisement premiums by removing the requirement to pay marriage value.
**Scheme 1**
Under Scheme 1, it is assumed that the leaseholder is not in the market at the time the premium is calculated and will never be in the market.

This assumption produces a premium based on the value of “the term” and “the reversion” only. The extra value attributable to the leaseholder being in the market (marriage value and hope value) is therefore not payable.

Scheme 1 reflects what the landlord would receive if the lease ran its course and the leaseholder never chose to extend the lease or acquire the freehold: the landlord would receive the ground rent (“the term”) and would get the property back at the expiry of the lease (“the reversion”).

**Scheme 2**
Under Scheme 2, it is assumed that the leaseholder is not in the market at the time the premium is calculated, but may be in the market in the future.

This assumption produces a premium based on the value of the term, the reversion, and (in certain cases) hope value. The extra value attributable to the leaseholder being in the market on the valuation date (marriage value) is therefore not payable.

Scheme 2 reflects what the landlord would receive if his or her interest were sold to a third party. An investor purchasing the freehold would not pay marriage value (because the leasehold and freehold interests would remain in separate ownership, so marriage value would not be realised). But an investor might pay hope value, to reflect the fact that he or she might in the future be able to realise the marriage value by selling the interest to the leaseholder.

**Scheme 3**
Under Scheme 3, it is assumed that the leaseholder is in the market at the time the premium is calculated.

This assumption produces a premium based on the value of the term, the reversion and marriage value (where it exists).

Scheme 3 reflects what the landlord would receive for his or her interest if sold to the leaseholder. By acquiring the landlord’s interest, the leaseholder realises the marriage value, and so would pay the landlord for it.

Scheme 3 reflects the way in which premiums are calculated under the current law, but when combined with other reforms Scheme 3 can still be used to reduce premiums.
Leasehold home ownership: buying your freehold or extending your lease – a summary

Effect of the three schemes on the enfranchisement premium for House A

<table>
<thead>
<tr>
<th>Details of existing lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unexpired term</td>
</tr>
<tr>
<td>Ground rent</td>
</tr>
<tr>
<td>Value on freehold basis</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Enfranchisement premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuation under:</td>
</tr>
<tr>
<td>Part (1): term</td>
</tr>
<tr>
<td>Part (2): reversion</td>
</tr>
<tr>
<td>Part (3): marriage / hope value</td>
</tr>
<tr>
<td>Total premium</td>
</tr>
</tbody>
</table>

Within each of the overall schemes: seven sub-options (see Chapter 6 of the Report)

Within each of the three schemes, there is a series of further options for reform. These options could feature in any of the three overall schemes.

Reforms that would (or could) reduce premiums

Sub-option (1) Prescribing rates

We explain above the three main elements of an enfranchisement premium: “the term”, “the reversion” and “marriage value”. Each of those elements of the premium depends on a different “rate”.

The role of “rates” in calculating the premium

- To value “the term”, it is necessary to calculate a capital sum which reflects the right to receive the ground rent income in the future. A “capitalisation rate” is a rate of return which is used to calculate a capital sum that reflects the value of that income stream.
- To value “the reversion”, it is necessary to calculate a capital sum which reflects the value of the right to have the property back at the end of the lease. A “deferment rate” is used to discount the value of the freehold interest, to reflect the fact that instead of receiving the benefit of vacant possession of the property in the future, the landlord will receive money now.
- To assess “marriage value” and “hope value”, it is necessary to establish the relative value of the leasehold interest in a property compared to the freehold interest in the property. The percentage that is used in the valuation is called “relativity”.

---

17
Leasehold home ownership: buying your freehold or extending your lease – a summary
Those rates will continue to have a role under each of the three overall schemes that we set out above. That is because enfranchisement premiums under each scheme would continue to include an amount to reflect “the term” and “the reversion”. The schemes differ in their treatment of marriage value and hope value, but under Schemes 2 and 3, the rate that is used to calculate those sums (“relativity”) would continue to be relevant.

Leaseholders and landlords (and their professional representatives) will frequently disagree on the appropriate rates in their case. The rates that are used, and therefore the enfranchisement premium, in any case depend on the outcome of negotiations between the landlord’s valuer and the leaseholder’s valuer or (if agreement cannot be reached) on the outcome of litigation between the parties. The rates that are used can have a significant impact on the enfranchisement premium.

**Effect of different rates on the enfranchisement premium for House A**

The enfranchisement premium of £16,453 for House A is calculated using a capitalisation rate of 6%, a deferment rate of 4.75% and relativity of 90.5%.

If each of those rates are changed by 1% in favour of the leaseholder (to 7%, 5.75% and 91.5% respectively), the enfranchisement premium would reduce to £13,166.

If those rates were changed by 1% in favour of the landlord (to 5%, 3.75% and 89.5% respectively), the enfranchisement premium would increase to £21,852.

Leaseholders and landlords therefore face significant uncertainty about what the enfranchisement premium in any given case is likely to be.

In the Report, we conclude the enfranchisement process would be made more certain and predictable, simpler, more consistent, and cheaper if these rates were prescribed. The level of prescription could be at, or below, market value.

<table>
<thead>
<tr>
<th>Benefits of prescribing rates (at any level)</th>
<th>Certainty and predictability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplicity</td>
<td></td>
</tr>
<tr>
<td>Consistency</td>
<td></td>
</tr>
<tr>
<td>Removing unfair incentive structures</td>
<td></td>
</tr>
<tr>
<td>Reduced scope for inequality of power, and litigation tactics, to influence the outcome</td>
<td></td>
</tr>
<tr>
<td>Reducing costs, delays and litigation</td>
<td></td>
</tr>
</tbody>
</table>

| Benefits of prescribing rates (below market levels) | All of the benefits listed above, plus leaseholders would pay lower enfranchisement premiums. |

| Who would benefit? | Prescription at market rates would have benefits for all leaseholders and (in some cases) landlords. Prescription at below-market rates would benefit all leaseholders. |

**Sub-option (2) Capping the treatment of ground rent**

One of the three main elements of an enfranchisement premium is “the term”. Under each of the three schemes that we put forward, enfranchisement premiums would continue to include an amount to reflect the value of “the term”.

The value of “the term” depends on the level of the ground rent. The higher the ground rent, the higher the premium.

Some leases contain very high ground rents, or ground rents that will become very high in the future. Ground rents are generally considered to be onerous when they exceed 0.1% of the freehold value of the property.
Currently, the existence of an onerous ground rent makes it particularly important for leaseholders to be able to exercise their enfranchisement rights in order to escape from the liability, but the presence of the onerous ground rent makes the enfranchisement premium very high.

In the Report, we conclude that there could be a cap on the level of the ground rent that is taken into account when calculating the value of “the term”. That cap could be set at 0.1% of the freehold value of the property. In so far as the ground rent under a lease exceeds that cap, it would be ignored when calculating the enfranchisement premium.

This option for reform would benefit leaseholders whose leases contain an obligation to pay an onerous ground rent. The ground rent for House A is not onerous, so a cap would not affect the premium. But for other leaseholders, a cap would significantly reduce premiums. We give an example in the Report of a lease which includes an onerous ground rent (starting at £300 per annum and doubling every 10 years). A ground rent cap would reduce the enfranchisement premium from £79,425 under the current law to £6,253. (As with all of our examples, the precise figures would depend on the rates that are used in that case.)

**Benefits of capping ground rent in the valuation calculation**

<table>
<thead>
<tr>
<th>Who would benefit?</th>
<th>Reducing premiums for leaseholders with onerous ground rents.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leaseholders who currently have onerous ground rents or whose ground rents may or will in the future (following review) become onerous, regardless of the length of their lease.</td>
<td></td>
</tr>
</tbody>
</table>

**Sub-option (3) Development value**

In some enfranchisement claims, the premium may be increased in order to reflect the development potential of the land being acquired. Most enfranchisement claims by individual leaseholders (for a lease extension, or to acquire the freehold of their house) would not include development value. But a requirement to pay development value can arise in an enfranchisement claim by a group of leaseholders in a block of flats to purchase the freehold of that block; they may be required, for example, to pay an additional sum to reflect the value of building further floors of flats on top of the block. Development value is payable even if the leaseholders acquiring the freehold have no intention to carry out any development.

This additional value would continue to be payable under each of the three schemes that we set out above.

In the Report, we conclude that leaseholders could be given a power to decide to accept a restriction on future development of their block when they acquire the freehold. If they chose to accept that restriction, they would not have to pay the landlord any development value in the enfranchisement claim – so their enfranchisement premium would be reduced. If the leaseholders subsequently decided that they wanted to develop the block and therefore “realise” the development value, they could negotiate with the former landlord to release the restriction. They would, at that stage, have to make a payment to the former landlord in respect of the development value.
Benefits of restricting development

- Premiums would be reduced at the time of the enfranchisement claim.

Who would benefit?

- Leaseholders of flats acquiring the freehold of their block, as they would not be required to pay the landlord an additional sum to reflect the potential to develop their properties.
- Leaseholders and landlords, as disputes, negotiation and litigation about development value would be reduced.

Sub-option (4) Differential pricing for different types of leaseholder

Enfranchisement rights were originally introduced in order to benefit owner-occupiers, but have since been expanded to all leaseholders (including, for example, buy-to-let landlords and other investors).

It would be possible to reform the valuation regime so that owner-occupiers benefit from reduced premiums, but commercial investors do not. Such an approach might be one way to ensure compliance with landlords’ human rights, since the aim of enabling people to exercise enfranchisement rights in relation to their homes (rather than in relation to a financial investment) could justify a lower premium.

In the Report, we conclude that there are significant drawbacks to a regime that differentiates between different categories of leaseholders. But it would be possible. And if Government wishes to reduce premiums to a level that cannot be justified under A1P1 if it applies to all leaseholders, then it could be necessary for Government to create such a distinction.

Benefits of differential pricing

- Owner-occupiers would benefit from a lower enfranchisement premium.
- The policy of reducing premiums for leaseholders may be easier to justify under A1P1.

Who would benefit?

- Leaseholders who are owner-occupiers, regardless of the length of their lease.

Reforms that would only reduce premiums if adopted alongside other reforms

We set out three further sub-options for reform. By themselves, they would increase premiums for particular leaseholders – which would be contrary to our Terms of Reference. In accordance with our Terms of Reference, we only present them as options if they are pursued alongside other measures, so that the overall effect is to reduce premiums. The potential advantages of these three sub-options do not relate to the reduction of premiums, but other benefits such as simplifying the process or removing inconsistencies.

Sub-option (5) 80-year cut-off in respect of marriage value

Leaseholders must pay 50% of the marriage value if their lease has 80 years or less left to run. If the lease has more than 80 years left to run, they do not have to pay any marriage value.

Under Scheme 1, marriage value would not be payable in any event and so the 80-year cut off would become redundant. Under Schemes 2 and 3, marriage value or hope value would be payable, and there would still be a role for the 80-year cut-off.

If rates are prescribed, the time and expense of calculating marriage value would be reduced, and it would be possible to remove the 80-year cut off. But the result would be that leaseholders with more than 80 years left to run would have to pay marriage value or hope value.

We conclude that the 80-year cut-off should be retained, otherwise premiums would increase for leaseholders with more than 80 years unexpired. That conclusion is subject to the possibility of removing the 80-year cut-off in combination with other reforms that would have the overall effect of reducing premiums.
| Benefits of removing the 80-year cut-off | For landlords, an arbitrary cut-off for the payment of marriage value would be removed. Distortion of the market would be avoided, and the artificial cliff edge faced by leaseholders approaching the 80-year point would be removed. |
| Who would benefit? | Landlords of leases with more than 80 years left to run, because removing the cut-off would increase premiums. Leaseholders would not benefit unless this option is combined with other measures that would have the overall effect of reducing premiums. |

**Sub-option (6) Discount for leaseholders’ improvements**

The freehold value of a property is relevant to the valuation of “the reversion” and “marriage value”. It therefore remains relevant under each of the three overall schemes that we set out above.

Any increase in the value of the property which is the result of an improvement carried out by the leaseholder can be discounted from the freehold value. The effect is to reduce the premium. But identifying relevant improvements, and the appropriate discount, can be the source of much dispute between the leaseholder and landlord, leading to professional and litigation costs.

In the Report, we conclude that the discount should be retained, otherwise premiums will be increased for some leaseholders. However, we conclude that the discount could be simplified, limited or even removed in order to reduce disputes if such a reform were combined with other reforms to reduce premiums overall.

| Benefits of removing the discount for leaseholders’ improvements | Simplification, reducing the potential for disputes. |
| Who would benefit? | Landlords, because the effect of the discount is always to reduce premiums. Landlords and leaseholders would no longer incur costs when there are disputes about leaseholders’ improvements. |
Sub-option (7) Discount for the risk of holding over

When a long lease comes to an end, the leaseholder often has statutory rights to remain in the property paying a rent to the landlord. It is known as a right to “hold over”.

Similarly to the discount for leaseholders’ improvements, the right to hold over can reduce the value of the freehold, and therefore also reduce the enfranchisement premium. But the discount also creates some problems.

In the Report, we conclude that the discount for holding over should be retained, otherwise premiums will be increased for some leaseholders. However, we conclude that the discount could be removed, limited or prescribed in order to reduce disputes if such a reform were combined with other reforms that would reduce premiums overall.

| Benefits of removing the discount for the risk of holding over | Simplification, reducing the potential for disputes. |
| Who would benefit? | Landlords, because the effect of the discount is always to reduce premiums. Landlords and leaseholders would no longer incur costs when there are disputes about the discount for holding over. |
Summary of options for reform

Three alternative options for valuation framework

Scheme 1
Assume leaseholder is never in the market

- Sub-option 1: Prescribe rates for certainty and predictability
- Sub-option 2: Cap the treatment of ground rent at 0.1%
- Sub-option 3: No payment for development value
- Sub-option 4: Favourable premiums for owner-occupiers
- Sub-option 5: Remove 80-year cut-off for marriage value
- Sub-option 6: Remove discount for leaseholders’ improvements
- Sub-option 7: Remove discount for holding over

Scheme 2
Assume leaseholder is not now in the market, but may be in the future

- Term + Reversion
- Sub-option 2: Cap the treatment of ground rent at 0.1%
- Sub-option 3: No payment for development value
- Sub-option 4: Favourable premiums for owner-occupiers
- Sub-option 5: Remove 80-year cut-off for marriage value
- Sub-option 6: Remove discount for leaseholders’ improvements
- Sub-option 7: Remove discount for holding over

Scheme 3
Assume leaseholder is in the market

- Term + Reversion
- Term + Reversion + Hope value
- Term + Reversion + Marriage value

Online calculator for enfranchisement premiums
How would leaseholders benefit from the options set out in the Report?

Every leaseholder (regardless of lease length) benefits from...

Sub-option 1: prescribed rates

Sub-option 2: capped ground rent (if they have an onerous ground rent)

Sub-option 3: no payment for development value (if the claim is for the freehold of a block of flats)

Sub-option 4: favourable premiums for owner-occupiers (if they are owner-occupiers)

Sub-option 5: removal of 80-year cut-off for marriage value

Sub-option 6: removal of discount for leaseholder’s improvements

Sub-option 7: removal of discount for holding over but only if the reform is combined with other measures to reduce premiums

Every leaseholder with 80 years or less to run benefits directly from...

Scheme 1

Scheme 2

...regardless of which scheme is adopted

...regardless of which sub-options are adopted
Working towards an online calculator
(See Chapter 7 of the Report)

In Chapter 7 of the Report, we explore the possible role of an online calculator in a new enfranchisement valuation regime.

Whilst valuation is complex, it does not have to be complex for the user. It would be possible for an online calculator to be made available which could tell leaseholders and landlords – in certain circumstances – what the enfranchisement premium will be.

An online calculator would deliver significant benefits.

1. It would be simple to use.
2. It would increase certainty and predictability for the parties to an enfranchisement claim, so leaseholders and landlords would know where they stand.
3. It would remove the layers of complexity and inaccessibility which many consultees argued surround valuation.
4. It would significantly reduce the current scope for argument between the parties, consequential delays and associated professional costs.

Each of the three overall schemes that we put forward would accommodate an online calculator. But an online calculator could only be produced if rates are prescribed (see Sub-option 1 above).

| Benefits of an online calculator | Simplicity and accessibility  
|----------------------------------|-----------------------------  
|                                  | Certainty and predictability |  
|                                  | Reduced professional costs  
|                                  | Reduced scope for inequality of power, and litigation tactics, to influence the outcome |  
|                                  | Reduced disputes, costs and delays |  

| Who would benefit? | Leaseholders (regardless of the length of their lease) and landlords. |
The role of a simple formula  
*(see Chapter 6 of the Report)*

In the Consultation Paper, we discussed the possibility of introducing a reformed valuation scheme which set enfranchisement premiums according to a simple formula, rather than by assessing the market value of the asset being acquired.

1. We discussed the regime in Scotland, which sets a formula which is based on a “capitalised ground rent”. That regime only applies to very long leases which have a low ground rent.

2. We discussed suggestions that had been made for the introduction of a “ground rent multiplier”, so that enfranchisement premiums could be calculated based on (say) ten times the ground rent.

3. We discussed the possibility of calculating enfranchisement premiums based on a percentage of the freehold value of the property.

These schemes could result in enfranchisement premiums reducing for all leaseholders, regardless of the remaining length of their leases.

The majority view of leaseholders responding to our consultation was that enfranchisement premiums should be based on the ground rent multiplied by 10. The views expressed by these leaseholders were strongly-held and unequivocal. Many leaseholders’ responses demonstrated their exasperation with the current regime, and their view that a simple formula of 10 times ground rent was an obvious and fair solution to many of the problems associated with calculating enfranchisement premiums.

If enfranchisement premiums were to be based on a ground rent multiplier in all cases, the regime would be very unlikely to be compatible with A1P1. We do not, therefore, put it forward as an option for reform in the Report.

Counsel advised as follows:

Under this valuation method, the only factor that would be used to determine the premium is the ground rent. The ground rent figure itself may be an arbitrary amount which bears no relation to the capital value of the property. This means that the resulting premium on enfranchisement would be arbitrary. The valuation method would take no account of the reversionary value (which may be substantial) or the length of the lease. Consequently, a premium based solely on the ground rent is likely to be arbitrary, bear no relation to the value of the landlord’s asset and be too inflexible to take account of differing situations. I consider that such a valuation method is unlikely to be compatible with A1P1, and I estimate the risk of a successful challenge to such a valuation method as High. It should be disregarded.

Similarly, if enfranchisement premiums were to be based on a percentage of freehold value in all cases, the regime would be very unlikely to be compatible with A1P1. We do not, therefore, put it forward as an option for reform in the Report.

Counsel advised as follows:

Under this valuation method, the premium would be set at a percentage of the capital value of the freehold. The premium would not reflect the length of the lease or any difference in the ground rent payable. It would therefore be equally as inflexible as a ground-rent multiplier. Depending on what percentage was set, it may result in higher premiums. I consider that such a valuation method is unlikely to be compatible with A1P1, and that the risk of a successful challenge to such a valuation method is High. It should also be disregarded.

Given the risk of a successful challenge on human rights grounds to either of these valuation approaches, we conclude that they should not be pursued as an option for reform in all enfranchisement claims.
In more detail: the problems with a simple formula if used in all cases

The problems with a ground rent multiplier, if used in all cases:

- a universal ground rent multiplier would not reflect the true value of “the term”. For example, a premium based on 10 times ground rent would be the same whether the lease had 10 years or 200 years unexpired, but the value of the right to receive an annual ground rent for 10 years is far less than the value of the right to receive that annual ground rent for 200 years.

- a universal ground rent multiplier would not reflect the true value of “the reversion” or marriage value, because the value of those elements of the premium depend on the length of the lease (not on the ground rent). The right to receive the property back in 200 years is far less than the value of the right to have the property back in 10 years.

In House A, the vast majority of the total enfranchisement premium of £16,453 comprises “the reversion” (£7,349) and the marriage value (£7,298). The value of “the term” (£1,806) is relatively low.

So a multiplier of ground rent, if applied in all cases, would not be reflective of the true value of the asset to the landlord. That is mainly because a ground rent multiplier takes no account of the length of the lease and it does not reflect the value of the reversion or marriage value.

The problems with a percentage of freehold value, if used in all cases:

- an enfranchisement premium based on freehold value would not reflect the value of “the term”, because the value of that element of the premium depends on the ground rent (not on the freehold value). If a lease has 100 years to run, a premium based on (say) 1% or 10% of the freehold value would be the same whether the ground rent was £5 or £500 per annum. But the right to receive £500 per annum is worth more than the right to receive £5 per annum.

- similarly, a percentage of capital value does not reflect the true value of “the reversion”. A premium based on (say) 1% or 10% of the freehold value would be the same whether the lease had 10 years or 200 years unexpired, but the value of the right to have the property back in 200 years is far less than the value of the right to have the property back in 10 years.

So a percentage of capital value, if applied in all cases, would not be reflective of the true value of the asset to the landlord. That is because it takes no account of the length of the lease or the level of the ground rent.

However, that is not to say that a simple formula has no potential role in a reformed valuation regime.

For a limited category of cases, a simple formula could be used either:

1. to implement one of the three overall schemes set out above; or
2. (in the event that there is no wholesale reform and Government rejects the three schemes set out above) as a stand-alone regime for straightforward and low-value enfranchisement claims.
In more detail: using a simple formula

A scheme similar to the Scottish legislation could be introduced. It could apply to leases which are similar to the leases to which that regime applies, namely very long leases (so the value of the reversion is minimal) and where the ground rent is fairly low and is not subject to review. Alternatively, a ground rent multiplier could be used for similar leases – very long leases (so the value of the reversion is minimal) where the ground rent is fairly low and not subject to review.

The main problem with such an approach is that many leases would not fall within the scheme. That is because there is a wide range of leases in England and Wales, including short leases (where the value of the reversion is high) and leases with high ground rents or complex review structures (where the value of the term is high). Consequently, the applicability and, therefore, benefit of such a scheme is likely to be limited.

Nevertheless, we put this approach forward as an option that Government might wish to consider, particular in light of the support and attention that simple formulae have attracted.

1) A simple formula as a mechanism to implement (in part) one of the three overall schemes

A scheme along these lines could be used to implement one of the three overall schemes set out above for a limited category of leases.

But doing so would add complexity to the law and would not produce any different results. That is because, if rates are prescribed and an online calculator is introduced, then the schemes that we put forward could be made as accessible and easy to apply as a regime based on the Scottish legislation or a ground rent multiplier. It does not therefore seem necessary if Government adopts a new overall scheme.

2) A simple formula as a stand-alone regime for straightforward and low-value claims

If the current valuation regime stays the same, there would still be scope for the introduction of a simple formula for a limited category of straightforward and low-value claims.
The “original valuation basis” (see Chapter 9 of the Report)

In Chapter 9, we discuss the “original valuation basis” of calculating the premium and set out the options for how that basis of valuation could be reformed.

The original valuation basis applies to some leaseholders of houses who are purchasing their freeholds, where the house falls under certain financial limits.

The responses to our consultation have suggested that it is still widely used, particularly in areas such as the Midlands and South Wales.

Valuations under the original valuation basis are attractive to leaseholders because they produce a premium which is always significantly lower than a premium calculated under the mainstream valuation basis.

On the other hand, the original valuation basis gives rise to problems for leaseholders, as well as for landlords. There are problems both with the qualification criteria (working out which houses qualify for a valuation under the original valuation basis) and the valuation methodology (working out how to calculate the premium). These problems mean that the original valuation basis is outdated and difficult to use, which can increase costs for leaseholders and landlords, as well as increasing the risk of the premium being calculated incorrectly.

<table>
<thead>
<tr>
<th>Qualification criteria</th>
<th>Valuation methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unworkable</strong>&lt;br&gt;Whether a house qualifies under the original valuation basis can often depend on the house’s historic “rateable value” (a predecessor to council tax) which can be difficult or impossible to trace.</td>
<td><strong>Too complex</strong>&lt;br&gt;The way the premium is calculated under the original valuation basis is very difficult to understand and implement, especially for leaseholders.</td>
</tr>
<tr>
<td><strong>Arbitrary</strong>&lt;br&gt;The original valuation basis originally applied only to low value houses. Today, however, it no longer applies to all low value houses (some low value houses do not qualify for the more favourable valuation) or only low value houses (some high value houses qualify for the more favourable valuation).</td>
<td><strong>Unfair on landlords</strong>&lt;br&gt;Some people argue that the original valuation basis fails to compensate landlords properly when leaseholders purchase their freeholds. This is mainly because (in contrast to the mainstream valuation basis) a landlord is compensated primarily for the loss of the site, but not the loss of the building built on the site.</td>
</tr>
</tbody>
</table>

In the Report we put forward two options for Government for reform of the original valuation basis:

1. **Retain the original valuation basis indefinitely and largely in its current form:** it could be retained as an exception to the mainstream valuation basis. Whilst this approach would not solve the problems set out above, it is the only way to ensure that all leaseholders who currently qualify under the original valuation basis would continue to benefit from this more favourable valuation (as opposed to having to pay a higher premium under the mainstream valuation basis). Prescribing rates would simplify the calculation and may even enable the use of an online calculator.

2. **Replace the original valuation basis with an entirely new scheme:** a more fundamental and far-reaching reform would be to replace the original valuation basis with an entirely new scheme designed accurately to identify (all and only) low value properties and provide them with a more favourable way of calculating premiums than higher value properties. A new scheme could apply to low value flats as well as houses, and so incorporate all low value homes. The new scheme would aim to be easier to understand and more suited to the realities of modern leasehold ownership than the original valuation basis. For example, leaseholders would not have to locate their rateable values to qualify for a valuation under the new scheme. The new scheme would also operate consistently to ensure that it includes all low value properties and excludes all higher value properties.
CONCLUSION

We have set out the options for wholesale reform of the valuation regime in order to reduce enfranchisement premiums for leaseholders whilst ensuring that landlords receive sufficient compensation. Landlords will oppose any reforms that would reduce premiums, and we expect that some leaseholders will say that the options that we set out do not go far enough. The options that we have set out are detailed and nuanced, and reflect the limitations of human rights law. It is now for Government to decide which of the options to pursue, and then for Parliament to pass an Act of Parliament to implement that reform.
Leasehold home ownership: buying your freehold or extending your lease

Report on options to reduce the price payable

To the Right Honourable Robert Buckland QC MP, Lord Chancellor and Secretary of State for Justice

Chapter 1: Introduction

THIS REPORT

1.1 Leasehold enfranchisement is the process by which people who own property on a long lease ("leaseholders") may extend the lease, or buy the freehold. In order to exercise enfranchisement rights, leaseholders must pay a sum of money ("a premium") to their landlord.

1.2 We have consulted on wide-ranging reforms to the enfranchisement regime, which would require primary legislation to implement.

1.3 This first report concerns solely the issue of how premiums are calculated. Our Terms of Reference, agreed with Government, include a specific provision in respect of premiums.

Government has asked us “to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests”.

---

1 We generally use the term “leaseholder” instead of “tenant” when describing those who enjoy enfranchisement rights. We do so because “leaseholder” is typically used to denote those holding long leases of properties (who therefore qualify for such rights), whereas “tenant” is generally used to refer to those with short leases (such as a one-year “assured shorthold tenancy”). However, the enfranchisement legislation uses the word “tenant”, and, in some instances, we adopt that language when referring to the legislation – for example, when referring to a “qualifying tenant”.

2 There is an exception: leaseholders of houses can extend their lease without paying a premium but instead paying a higher annual rent. See para 2.5 below.
1.4 In accordance with our Terms of Reference:

(1) we set out options for reducing premiums and for simplifying the way in which premiums are calculated; but

(2) we do not make a recommendation as to how premiums should be calculated. That is not just a legal question: it involves considerations of law, valuation, social policy, and political judgement, and is therefore for Government and ultimately Parliament to decide.

1.5 This report enables Government and Parliament to decide how premiums should be calculated, informed by the consultation responses that we have received and our own expertise and analysis.

1.6 Our second report, to be published later this year, will address all other aspects of a reformed enfranchisement regime. In that report, we will make recommendations as to how the regime should be reformed.

1.7 Alongside our second report on enfranchisement, we will also publish our final recommendations for reform in respect of our related projects on:

(1) the right to manage, which is a right for leaseholders to take over the management of their building without buying the freehold. They can take control of services, repairs, maintenance, improvements, and insurance; and

(2) commonhold, which allows for the freehold ownership of flats (and other interdependent properties), offering an alternative way of owning property which avoids the shortcomings of leasehold ownership.

WHAT IS LEASEHOLD OWNERSHIP?

1.8 Many people own, or aspire to own, a home. But what does “ownership” mean? When an estate agent markets a house or flat as being “for sale”, what is the asset on offer? In England and Wales, property is almost always owned on either a freehold or a leasehold basis.

(1) Freehold is ownership that lasts forever, and generally gives fairly extensive control of the property.

(2) Leasehold provides time-limited ownership (for example, a 99-year lease), and control of the property is shared with, and limited by, the freehold owner (that is, the landlord).

1.9 So we refer to “buying” or “owning” a house or a flat. But when we buy on a leasehold basis, we are in fact buying a house or flat for a certain number of years (after which the assumption is that the property reverts to the landlord). A leasehold interest is

---

therefore often referred to as a wasting asset: whilst it may increase in value in line with property prices, its value also tends to reduce over time as its length (the “unexpired term”) reduces. There comes a point when the remaining length of the lease makes it unsaleable, because purchasers cannot obtain a mortgage (since lenders will not provide a mortgage for the purchase of a short lease).

1.10 In addition, leasehold owners often do not have the same control over their home as a freehold owner. For example, they may not be able to make alterations to their home, or choose which type of flooring to have, without obtaining the permission of their landlord. The balance of power between leasehold owners and their landlord is governed by the terms of the lease and by legislation.

1.11 As well as this division of control, a landlord may have different interests from the leaseholders. For instance, the landlord may see a leasehold property solely as an investment opportunity or a way of generating income, while for leaseholders the property may be their home, as well as a capital investment.

1.12 We explain the reasons why houses and flats are held on a leasehold basis in Figure 1 below.

**Figure 1: Why are houses and flats held on a leasehold basis?**

Flats are almost universally owned on a leasehold, as opposed to freehold, basis. That is because, for historic reasons, certain obligations to pay money or perform an action in relation to a property (such as to repair a wall or a roof) cannot legally be passed to future owners of freehold property. These obligations are especially important for the effective management of blocks of flats. For instance, it is necessary that all flat owners can be required to pay towards the costs of maintaining the block, which is important since flats are structurally interdependent. There are therefore good reasons, under the current law, why flats are sold on a leasehold basis.

But leasehold ownership is not limited to flats. Sometimes houses are sold on a leasehold basis. That has been the case for some years. The first piece of enfranchisement legislation enacted in 1967 – the Leasehold Reform Act 1967 (“the 1967 Act”) – granted enfranchisement rights to leaseholders of houses. More recently, new-build houses have been sold on a leasehold basis. That allows developers to sell the property subject to an ongoing obligation to pay a ground rent. The right to receive a ground rent (in respect of both houses and flats) is a valuable asset, which can then be sold to an investor. Concerns have been raised about the sale of houses on a leasehold basis, and the UK Government has announced its intention to ban the sale of leasehold houses.

---

4 Historically, the sale of houses on a leasehold basis became widespread practice in particular areas of the country.

The reasons for selling houses on a leasehold basis are less apparent than those for leasehold flats. One reason might be the need to impose positive obligations on house owners in relation to the upkeep (management) of an estate, but that does not apply in all cases.

The reasons why, for legal purposes, houses and flats may be sold on a long lease do not, however, require the lease to provide income streams to the landlord, beyond those needed to maintain the property, the block, or the estate.

In many countries, leasehold ownership does not exist. Instead, forms of strata or condominium title are used so that flats can be owned on a freehold basis. In England and Wales, commonhold was introduced as an alternative to leasehold in 2002 (by the Commonhold and Leasehold Reform Act 2002), to enable the freehold ownership of flats. Commonhold allows the residents of a building to own the freehold of their individual units and to manage the shared areas through a company. Commonhold has not, however, taken off – fewer than 20 commonholds have been created since the law came into force.6

Alongside our work on enfranchisement, we are carrying out a separate project to consider the various legal issues within the current commonhold legislation which affect market confidence and workability. We will recommend reforms that would allow commonhold to be reinvigorated as a workable alternative to leasehold, for both existing and new homes.7 We will publish our final report later this year.

The purpose of a leasehold home

---


7  For more information on our project on commonhold, see https://www.lawcom.gov.uk/project/commonhold/.
WHAT ARE ENFRANCHISEMENT RIGHTS?

1.13 As a consequence of the features of leasehold ownership described above, legislation has been enacted that gives leaseholders “enfranchisement rights”.

(1) Leaseholders have a right to extend their lease (“the right to a lease extension”), which provides them with longer-term security in their home and goes some way to overcoming the problem of owning a wasting asset. Leaseholders’ security in their home, and the value of their asset, is far better protected if they can extend, say, a 60-year lease to 150 years.

(2) Leaseholders of houses have a right to purchase their freehold, and leaseholders of flats have a right, acting with the other leaseholders in their building, to purchase the freehold of their block. Freehold acquisition provides leaseholders with the same advantages as a lease extension (namely, security in their home and protecting the value of their asset), but also allows leaseholders to gain control of their property from a landlord.

1.14 We summarise the current law of enfranchisement, and its history, in Chapter 2 of our Consultation Paper.8

1.15 In order to exercise enfranchisement rights, leaseholders must pay their landlord a “premium”.9

WHAT ARE PREMIUMS?

1.16 The result of an enfranchisement claim is that the leaseholder acquires, from the landlord, an enhanced interest in their property. Put another way, an enfranchisement claim involves the transfer of a property right (a longer lease or the freehold) from the landlord to the leaseholder.

1.17 The landlord’s entitlement under the lease, which is lost on enfranchisement, is valuable to the landlord. Equally, the enhanced interest acquired by the leaseholder though the enfranchisement claim is valuable to the leaseholder.

1.18 Leaseholders must therefore make a payment to their landlord to reflect the value of the enhanced interest that they acquire from the landlord: see Figure 2. We use the term “premium” to describe this payment, but it is sometimes also referred to as a “price” or “compensation”.

---


9  Unless they are a leaseholder of a house and seeking a lease extension as opposed to buying the freehold.
Figure 2: An example – why must leaseholders pay a premium?

A leaseholder has 60 years remaining on his or her lease, and is required by the lease to pay the landlord a ground rent of £200 per year.

The landlord is entitled to have the property back in 60 years’ time, and to receive the ground rent.

Result of an enfranchisement claim under the current law: flats

The lease is extended by 90 years, so the landlord will not now be entitled to have the flat back for 150 years.

The ground rent is reduced to a peppercorn (nil monetary value), so the landlord will no longer be entitled to the ground rent of £200 per year for the next 60 years.

Result of an enfranchisement claim under the current law: houses

The leaseholder purchases the freehold, so the landlord will not now be entitled to have the house back at all, and will no longer be entitled to the ground rent of £200 per year for the next 60 years.

Requirement to pay a premium

The landlord is no longer entitled to the property in 60 years, and is no longer entitled to ground rent. The leaseholder must make a payment to the landlord to reflect the fact that the landlord’s entitlements under the lease are reduced or removed.

1.19 Calculating the premium is known as “valuation” as it involves putting a financial value on the interest that the landlord is losing and that will be acquired by the leaseholder. Broadly speaking, enfranchisement premiums are intended to reflect the “market value” of the landlord’s asset. The market value is the amount that an asset is worth if sold in the open market.

The views and opposing interests of landlords and leaseholders

1.20 Throughout the responses to the Consultation Paper, and our Leaseholder Survey,10 the strength of feeling of many consultees – particularly of leaseholders – was evident. A large number of leaseholders expressed their anger at finding themselves in the situation of having to pay an enfranchisement premium, and more generally at the perceived injustices with leasehold. There were also many leaseholders who found their ownership of a leasehold property, along with their attempts at enfranchisement or sale, to be emotionally distressing, or a source of significant stress or unhappiness. We appreciate the time that all consultees have taken in responding to the Consultation Paper and Leaseholder Survey, and in expressing their views to us. Although we have not been able to engage with each person individually, the responses we received have fed into the options for reform in this report (and our forthcoming recommendations for reform in our second report), providing real-world and useful examples of some of the issues arising in leasehold and enfranchisement law.

---

10 See, further, para 1.62 below.
1.21 The strength of feeling evident from consultees, especially from leaseholders, was particularly obvious with respect to the requirement to pay a premium in order to make an enfranchisement claim, and the level of that premium. Leaseholders who have already paid a substantial sum to buy their home felt that, through enfranchisement, they were having to pay twice. When it comes to calculating premiums, the interests of leaseholders and landlords are diametrically opposed. Leaseholders want lower premiums; landlords want higher premiums. Any reform that reduces premiums will be beneficial to leaseholders, at the expense of landlords who will receive less money for the lease extension or the freehold. Any reform that increases premiums will be beneficial to landlords, at the expense of leaseholders who will have to pay more money for the lease extension or the freehold.

Views on the fairness of enfranchisement premiums

1.22 It is clear to us, from our consultation events and from consultation responses, that many leaseholders and landlords have fundamentally different and irreconcilable views about whether the requirement to pay premiums is fair, and about whether the basis of calculating those premiums is fair.

1.23 We explore the arguments further in Chapter 3, but summarise them below.
The difference between premiums and professional costs

1.24 This report is concerned principally with premiums, and the way in which they are calculated – which is referred to as “valuation”.

1.25 In addition to the premium, enfranchisement also costs money as a result of the professional fees of lawyers and valuers relating to the enfranchisement procedure itself (“professional costs”). There are two categories of professional costs: (1) litigation costs, namely the costs incurred when there is a dispute between the parties which has to be resolved by the Tribunal or courts, and (2) non-litigation costs, namely the costs incurred as a result of the enfranchisement transaction itself, such as advice, valuation costs or conveyancing costs.

---

11 The First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal in Wales.
Professional costs are incurred by both leaseholders and landlords, although leaseholders are currently required to make a contribution towards their landlords’ non-litigation costs so the greater burden of professional costs falls on leaseholders. We considered whether and, if so, how leaseholders should contribute towards their landlords’ non-litigation costs in Chapter 13 of the Consultation Paper, and our second report will set out our recommendations for reform on that subject.

It is important to separate (i) the premium, from (ii) the non-litigation (and litigation) costs. They are two distinct components of the total cost to a leaseholder of exercising enfranchisement rights.

The premium is money paid to the landlord for the lease extension or freehold. The litigation and non-litigation costs will be paid to professionals such as lawyers and valuers. The two are, however, related, as changes to how the premium is calculated will have a direct effect on professional costs. That is because the simpler it is to calculate the premium, the lower the professional costs that are associated with valuation will be.

For the leaseholder, the cost of enfranchisement is the sum total of the premium and the professional costs (both their own professional costs and any contribution they are required to make towards their landlord’s non-litigation costs). Lowering the professional costs therefore lowers the total cost of enfranchisement. But that is not the same as lowering the premium. To lower the premium, it is necessary to consider the basis on which the premium is calculated: the only way to reduce the premium is to change the basis of the valuation.

Two broad methods of calculating premiums

Broadly speaking, under the current law there are two bases on which enfranchisement premiums are assessed.

(1) The “mainstream valuation basis” is based on an assessment of the market value of the landlord’s interest. It applies to all flats and many houses.

(2) The “original valuation basis” is based on an assessment of the market value of the land on which the house is situated, but not the value of the house itself, and results in lower premiums for leaseholders. It applies to houses (not flats) which fall below certain financial limits.

The original valuation basis applies to houses to which the enfranchisement legislation originally applied, and is set out in section 9(1) of the Leasehold Reform Act 1967 (“the 1967 Act”). It is therefore often also referred to as the “section 9(1) basis of valuation”.

In this Report, we first address the mainstream valuation basis (in Chapters 5 to 8), and then the original valuation basis (in Chapter 9).

OUR PROJECT

Our enfranchisement project is a wide-ranging examination of leaseholders’ enfranchisement rights. In September 2018, we published a Consultation Paper, setting out our provisional proposals for a new enfranchisement regime. Our consultation
closed in January 2019, and since then we have been analysing the responses and developing our recommendations for reform.

1.34 This report sets out our conclusions on premiums, and sets out options for reform. We will publish our second report, setting out our final recommendations for reform to all other aspects of the enfranchisement regime, early next year.

OUR TERMS OF REFERENCE: OPTIONS FOR REDUCING PREMIUMS, NOT RECOMMENDATIONS

1.35 Our Terms of Reference include two general policy objectives identified by Government, which are:

(1) to promote transparency and fairness in the residential leasehold sector; and

(2) to provide a better deal for leaseholders as consumers.

1.36 Our Terms of Reference include a specific provision in respect of premiums. While we have quoted this provision above, we repeat it here for ease of reference.

Government has asked us “to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests” (emphasis added).

1.37 This Report is focussed on identifying options for reform that reflect that term of reference.

1.38 Providing options to reduce the premium payable is not, however, the only part of our Terms of Reference that is relevant to valuation. We have also been asked:

(1) to produce options for a simpler, clearer and consistent valuation methodology;

(2) to simplify the legislation; and

(3) to make enfranchisement easier, quicker and more cost effective (by reducing the professional costs), particularly for leaseholders, including by introducing a clear prescribed methodology for calculating the premium.

1.39 Whilst our Terms of Reference include ensuring “sufficient” compensation is paid to landlords, it is not possible to reduce premiums without reducing the compensation which the landlord receives. We discuss the meaning of sufficient compensation further below.

1.40 There is no suggestion that existing leaseholders should be able to obtain a freehold or lease extension without paying the landlord an appropriate price; our task is to propose reforms to improve the enfranchisement process, and to set out the options for reducing premiums that are payable by leaseholders while ensuring sufficient compensation is paid to landlords.
SUFFICIENT COMPENSATION AND HUMAN RIGHTS

1.41 Our Terms of Reference require us to consider valuation options that ensure “sufficient compensation is paid to landlords to reflect their legitimate property interests”.

1.42 Views will invariably differ on what constitutes sufficient compensation. In legal terms, a central issue in determining whether compensation is “sufficient” is whether it is compatible with Article 1 of the First Protocol (“A1P1”) to the European Convention on Human Rights (“ECHR”), which provides for the peaceful enjoyment of property.

A1P1 to the ECHR (quoted in part)

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. …

1.43 A1P1 and most other rights under the ECHR (“the Convention rights”) have been incorporated into English law by the Human Rights Act 1998 (“the 1998 Act”). The Convention rights therefore form part of English law, and any reforms to the enfranchisement regime that we set out, which Government seeks to implement, and which Parliament enacts, need to be compliant with the Convention rights.

1.44 The 1998 Act requires Government to make a statement either (a) that, in its view, a proposed law is compatible with the Convention rights, or (b) that, even though such a confirmation cannot be given, Government nevertheless wishes the proposed law to proceed.12

1.45 The 1998 Act allows certain courts to grant a declaration that a provision of an Act of Parliament is incompatible with the Convention rights, and to award damages for any breach of Convention rights.13 In addition, a challenge can be brought in the European Court of Human Rights (“ECtHR”) which can decide that there has been a breach of the Convention rights and which can make an award of compensation.

1.46 Accordingly, if legislation that reduces premiums is not compatible with the Convention rights, a challenge could be made to the courts in England and Wales or to the ECtHR, and Government could be required to pay compensation to landlords whose rights have been infringed. The legislation is also likely to be amended in order to make it compatible with the Convention rights.

1.47 Our project, and the options for reform that we present, must therefore operate within human rights law.

1.48 During our project, some consultees have asserted that any reduction in enfranchisement premiums would be unlawful under A1P1. Of those consultees, some went further and supplied us with copies of opinions from barristers that they had instructed in order to support their arguments. It is clear that any reforms that reduce enfranchisement premiums are going to be carefully scrutinised. Given the necessity for a reformed valuation regime to be lawful under A1P1, we have obtained the opinion

12 1998 Act, s 19(1).

13 1998 Act, ss 4 and 8.
of Catherine Callaghan QC, which we refer to as “Counsel’s Opinion”, on the compliance with A1P1 of our options for reducing premiums in this Report. Ms Callaghan is a specialist human rights barrister, and we asked her to provide an independent opinion on whether the various options for reform would be lawful under A1P1. We have published Counsel’s Opinion, and our instructions to Counsel, alongside this Report.  

Leaseholders’ human rights

1.49 During our consultation events, and in their consultation responses, leaseholders often asked us why we were focusing on landlords’ human rights, and what consideration was being given to their own human rights.

<table>
<thead>
<tr>
<th>How are leaseholders’ human rights under the ECHR relevant? (Taken from Counsel’s Opinion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is important to bear in mind that leaseholders also enjoy rights that are protected under the ECHR. Leaseholders enjoy the right to the peaceful enjoyment of their possessions under A1P1. Residential leaseholders who are owner-occupiers also benefit from the right to respect for their home under Article 8. [Article 8 provides that “Everyone has the right to respect for his private and family life, his home and his correspondence.”] However, leasehold enfranchisement legislation does not interfere with leaseholders’ property rights under A1P1. Leaseholders’ interests are taken into account when determining the amount of compensation payable to landlords, as the exercise of assessing whether a fair balance has been struck necessarily entails balancing the interests of landlords against the interests of leaseholders, both in their own right and when considering the general interest of society.</td>
</tr>
</tbody>
</table>

Article 8 is not concerned with the right to own or occupy property as such.  

15 Article 8 is not engaged or violated either by the ordinary operation of a lease (which limits a leaseholder’s occupancy of the property to the term of the lease) or by requiring the leaseholder to pay for the extension of the lease or purchase the freehold to avoid that result.  

16

1.50 The law is clear that leaseholders cannot rely on their human rights under A1P1 or Article 8 to challenge the ordinary operation of their lease, including the fact that they must make an enfranchisement claim, and that they must pay a premium to do so.

Landlords’ human rights

1.51 Landlords’ human rights do not prevent leaseholders from buying their freeholds or extending their leases against the wishes of their landlord. But they do require leaseholders to pay a sufficient sum for the freehold or lease extension in order to justify the interference with the landlord’s property rights.

1.52 The premium that is paid by leaseholders to landlords is, therefore, relevant when assessing the compatibility of enfranchisement with A1P1. Any options for reform that

---

14 Available at https://www.lawcom.gov.uk/project/leasehold-enfranchisement/.


would reduce the premium must be tested for their compatibility with A1P1. Further, that is the case whether the landlord is an individual or a company.

How are landlords' human rights under A1P1 relevant? (Taken from Counsel's Opinion)

A1P1 protects the right to the peaceful enjoyment of possessions, and in substance guarantees the right of property. "Possessions" include real and immovable property, and therefore A1P1 protects any proprietary interest in land.

A1P1 can be invoked by any "natural or legal person" who has suffered an interference with their possessions for which the state is responsible, and can therefore be invoked not only by an individual but also by a company or other legal entity (whether based in the UK or elsewhere).

A1P1 is a qualified right. An interference with a person's property rights can be justified where a legitimate aim is pursued by reasonably proportionate means. This involves an assessment of whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's rights. The payment of compensation is relevant to the fairness of the balance struck.

Legislation which permits a leaseholder to compulsorily acquire the freehold or extend the lease of a house or flat interferes with a landlord's property rights under A1P1 and will only be lawful if the level of compensation payable to the landlord is sufficient to justify the interference with those property rights.

1.53 It is not necessary for landlords to be provided with full market value for their interest; there is some discretion within which property rights can be interfered with to achieve a legitimate aim. But generally the further away from market value the compensation is, the more difficult it is likely to be to justify the interference.

1.54 In this Report, we only put forward options for reform that are likely to be compatible with landlords’ rights under A1P1. We have not, therefore, put forward options that are unlikely to be compatible with landlords’ rights under A1P1. Our assessment of the compatibility of the options for reform that we put forward in the Report is based on Counsel’s Opinion. We asked Counsel to provide advice in accordance with the Government Legal Department’s “Guidance Note on Legal Risk”. Counsel’s Opinion therefore includes an assessment of whether the risk of a successful challenge to the various options for reform is “low”, “medium low”, “medium high” or “high”. We put forward options for reform which Counsel has assessed as being “low” or “medium low” risk. We have not put forward options which Counsel has assessed as being “medium high” or “high” risk.

1.55 Counsel’s Opinion concerns the compatibility with A1P1 of the various options for reform that we discuss throughout this report. Each of these options is a means of calculating the premium that should be paid to the landlord to compensate him or her for the loss of his or her property right. Another aspect of the compensation that landlords currently receive during an enfranchisement claim is a contribution towards their costs: see paragraphs 1.24 to 1.29 above. This Report concerns valuation, and so our, and Counsel’s, human rights analysis at this stage is limited to the compliance with

---

17 Marckx v Belgium (1979) 2 EHRR 350 (App No 6833/74) at [63]; Sporrong and Lönnroth v Sweden (1982) 5 EHRR 35 (App No 7152/75) at [57].

A1P1 of the various options for reducing premiums in this Report. Our final recommendations in our second report will address litigation and non-litigation costs, including the question of whether leaseholders should contribute towards their landlord’s non-litigation costs (as is currently required). Any assessment of whether the total amount of compensation that a landlord receives under a reformed enfranchisement regime complies with A1P1 will have to take into account whether a landlord is able to recover his or her non-litigation costs from the leaseholder. Our second report will therefore address the joint effect of the valuation options set out in this report and our recommendations concerning non-litigation costs on the compliance with A1P1 of a new enfranchisement regime.

THE OPTIONS FOR REDUCING PREMIUMS IN THIS REPORT

1.56 We set out the options for reform in Chapters 5 and 6 of this report, and summarise them in Chapter 8. As explained above, the options for reform set out in this Report reflect the requirement in our Terms of Reference to set out and examine options to reduce the premium payable by leaseholders whilst ensuring sufficient compensation is paid to landlords.

1.57 The options that we examine also seek to achieve the other aims set out in our Terms of Reference (see paragraph 1.38 above), for example, by increasing certainty or by reducing delays.

1.58 Throughout this Report, we highlight in boxes some of the key benefits of particular options for reform.

(1) We distinguish between two types of benefit. First, options for reform that would reduce premiums for leaseholders. Second, options for reform that would have other benefits, such as increasing certainty or reducing delays. Some options for reform would deliver both types of benefit; others (depending on how they are implemented) would deliver one or the other. Where an option does not, on its own, reduce the premium, we put it forward only on the basis that it could be used as part of a package of reforms which would have the overall effect of reducing the premiums.

(2) We set out who would benefit from those options for reform, and generally distinguish between leaseholders who currently have more, and those who have less, than 80 years left to run on their leases. That is because, under the current law, those with 80 years or less left to run pay marriage value whilst those with more than 80 years left to run do not.

1.59 Some of the options for reform that we set out in this Report could, if implemented, allow enfranchisement premiums to be ascertained by leaseholders through an online calculator. We discuss the way in which an online calculator could work in Chapter 7.

1.60 The Consultation Paper included questions in Chapter 16 about the valuation of intermediate leases.\(^{19}\) We will set out our final conclusions and recommendations on

\(^{19}\) An intermediate lease is a lease that is superior to another lease (in other words, a lease under which the leaseholder is also the landlord under another lease). Put another way, it is a lease that has an interest
those valuation points when we publish our second report later this year. This Report focusses on the options for reducing premiums, which were the subject of Chapters 14 and 15 of the Consultation Paper.

1.61 As we explained in the Consultation Paper, the different options for reform that we present in this report, and the recommendations that we will make in our second report, will have financial and non-financial implications for landlords and leaseholders, and for the wider property market and economy. Government will undertake impact assessments in relation to any reforms that it pursues. Throughout the Consultation Paper, we therefore asked various questions about the impact of problems under the current law, and the potential impact of reform, for the purposes of gathering evidence and data to be used in the preparation of those impact assessments.

THE CONSULTATION PAPER AND CONSULTATION EVENTS

1.62 Following publication of the Consultation Paper, we held various public consultation events around England and Wales in order to explain our proposals for reform, encourage discussion and debate about our proposals, gather attendees’ views and encourage people to provide written responses to the Consultation Paper. We also met with different groups of stakeholders to hear their views about reform. As well as inviting consultation responses, we invited leaseholders to respond to a survey to share with us their experiences of the enfranchisement process. We received over 1,100 responses to the Consultation Paper (consultees are listed in Appendix 1), and over 1,500 responses to the Leaseholder Survey.

1.63 As explained above, there were many strongly held views about leasehold reform, from leaseholders, landlords, professionals, and others. We have taken those views – expressed to us at consultation events and in written consultation responses – into account as we have developed the options for reform that we set out in this report.

How we have dealt with consultation responses

1.64 All of the responses we received to the Consultation Paper have been analysed as we have developed the options for reform that are set out in this Report.

Different categories of consultee and different interests

1.65 In carrying out our analysis of the consultation responses, we have categorised consultees as best we could, in order to assist with understanding the distribution of the views of different groups in respect of different topics.\(^{20}\) In doing so, however, we do not wish to suggest that everyone within a given category would have a single opinion that is necessarily different from those in other categories, but our categorisation sets out those consultees who broadly have the same or similar interests. To take a simple

above and below it. For example, where a freehold house is subject to a 999-year lease to X, which in turn is subject to a 125-year lease to Y, which itself is subject to a 99-year lease to Z, then the 999-year lease and the 125-year lease are both “intermediate leases”. The 125-year lease is also a “sub-lease” (as is the 99-year lease). An intermediate lease is also known as a “head lease” or a “superior lease”.

\(^{20}\) The categories that we have adopted are: leaseholders and representative bodies; commercial investors; social housing sector; charitable sector; legal professionals; surveyors; other professionals; and other consultees. Those are very broad categories. For example, commercial investors might include large pension funds, but also individuals who have a second home which they sell on a long lease to provide retirement funds.
example, landlords as a group were opposed to any reduction in premiums since their income from enfranchisement premiums would reduce, whereas leaseholders as a group were in favour of reduced premiums.

1.66 In addition, we have weighed the opinions of different stakeholders within these broad categories differently; for example, the opinion of a representative body will often carry greater weight than a response from one individual whom they represent.

Our approach to analysing consultation responses

1.67 It is inevitable that each consultee will have responded to our questions based on their own knowledge and experience, and we have borne this in mind when considering consultation responses. For example:

(1) the specialist lawyer or valuer may only deal with enfranchisement claims in one area of the country, or may see a disproportionate number of disputes relating to relatively technical parts of the existing legislation, yet have little experience of the large number of relatively low value, straightforward claims;

(2) the ground rent investor, who invests in relatively long leases, will be concerned about capitalisation rates being prescribed at below-market value, but will have little concern as to whether any reversionary value or marriage value is payable (we explain those concepts in Chapter 2 and in the Glossary);

(3) other landlords whose estates comprise relatively short leases with low ground rents will be concerned about reversionary value and marriage value, but might have less concern about whether and how capitalisation rates are set;

(4) leaseholders with short leases (with an unexpired term of up to 80 years) and relatively low ground rents will be concerned about whether and how marriage value is payable, but less concerned about capitalisation rates; and

(5) leaseholders with long leases (particularly those with high or onerous ground rent obligations) will have little interest in whether marriage value is payable, but will be concerned about whether and how capitalisation rates are set.

1.68 We emphasise that we have not made decisions, and do not present options for reform in this report, simply on the basis of the numbers of consultees who were in favour of, or against, a particular option. Further, we have necessarily had regard to whether options or suggested alternatives are, in fact, workable and practical. For example, they may not work because they are not compatible with A1P1 or because they will only work for a certain sector of the market.

Responses concerning valuation

1.69 We received a wide range of consultation responses concerning valuation. We are publishing those responses on our website alongside this report. A large number of responses from individuals, many of whom identified themselves as leaseholders, were in favour of a simple formula to calculate enfranchisement premiums, the most popular option being the ground rent multiplied by ten. Other responses, generally from professionals and also from landlords, expressed general views but also addressed some of the technical detail of reform.
1.70 There were some very technical questions in the Consultation Paper, and quite understandably many consultees did not fully understand them. Some consultees explicitly said they did not understand the question; with others it was apparent from their response that they had not understood; and with some it was difficult to tell. Nevertheless, the overall views of the different categories of stakeholder were clear to us, notwithstanding any misunderstanding, and we have taken them into account in formulating the options set out in this report.

Inequality of arms

1.71 In paragraph 3.45 onwards below, we discuss the inequality of arms that exists, broadly speaking, between leaseholders and landlords in the current enfranchisement process. It is a systemic inequality between leaseholders (as a whole) and landlords (as a whole), as opposed to an individual inequality as between particular people within those groups. That inequality of arms exhibited itself in the responses that we received to the Consultation Paper. Some of the responses that we received from landlords were very detailed and technical, some were prepared with professional assistance from lawyers or valuers, and some were accompanied by opinions prepared by barristers. For these landlords, it made commercial sense to incur costs in order to put forward the best arguments that they could and to try to protect their financial interests. Even where landlords did not incur additional costs, they were often providing their responses in reliance on their own expertise acquired from detailed knowledge of their business operations. (The notable exception is landlords which are leaseholder-owned.)

1.72 We are very conscious, though, that leaseholders who are not lawyers were not necessarily able to provide equivalent responses setting out their best arguments. Individual leaseholders do not, in general, have the same in-house expertise as many landlords and they do not have the funds to pay professionals for assistance in preparing a consultation response. Their knowledge of the law is often drawn only from their individual, personal experience. Nor did leaseholders, as a group, pool their resources in order to pay for such assistance. Various organisations exist to try to coordinate and campaign for the interests of leaseholders but they are unable to match the resources that some landlords are able and willing to spend.

1.73 We have carefully weighed all the information that has been provided to us. In doing so, we have been mindful that those best placed to respond to technical questions are professionals and that many of the professionals who responded to the Consultation Paper were either explicitly instructed on behalf of freeholders or are generally instructed on behalf of freeholders more than they are by leaseholders. That reflects the inequality of arms and incentive structures that currently exist, in particular outside Prime Central London, and which we explore further in Chapter 3.

ISSUES BEYOND OUR TERMS OF REFERENCE

1.74 Our project concerns enfranchisement reform, and this Report concerns only valuation of enfranchisement premiums. The options for reform that we set out in this report, and our forthcoming recommendations to reform the enfranchisement regime, would play a significant role in improving the position of leaseholders. But our project does not solve all the problems that leaseholders can currently face.
1.75 Some consultees wanted the proposals in the Consultation Paper to go further. For example, some leaseholders would like enfranchisement to provide an opportunity to re-write the terms of their existing lease, or to obtain a freehold that is as free of obligations owed to others as possible.

1.76 Enfranchisement is, however, concerned primarily with the financial terms on which an existing lease is to be extended or a freehold is to be obtained: for example, allowing leaseholders to “buy out” their obligation to pay a ground rent following a lease extension. We also think that enfranchisement is not the best means of dealing with other problems with the terms of leaseholders’ existing leases. It would provide no solution for leaseholders who are unable to enfranchise (perhaps because, for instance, they cannot afford to). And while we believe that the options to reform valuation in this report, and our forthcoming recommendations for reform, will increase the number of leaseholders who are able to enfranchise, there will remain leaseholders who are not able to do so.

1.77 Existing leaseholders may benefit from some of our other forthcoming work. Our project on commonhold seeks to bring new life to this alternative form of ownership that would allow flats to be owned freehold, and managed collectively. And our project on the right to manage aims to make it easier for leaseholders to take over the management of their building from their landlord – without having to pay the cost of acquiring the freehold.

1.78 The UK Government and Welsh Government are also carrying out related work. For example, the UK Government has set out its intention to ban the sale of houses on a leasehold basis, and to prohibit the reservation of ground rents with any financial value. It is considering proposals about the regulation of managing agents. The Welsh Government is currently considering proposals put forward by a cross-industry working group.

1.79 But some other problems identified by leaseholders remain outside the scope of these proposed reform projects. Other concerns may be addressed in the future as part of a comprehensive programme of leasehold reform. But it is necessary to prioritise. For now, the three projects that we are working on are each significant in themselves but also contribute to a wider programme of reform by Government. There may be scope for further reform work in the months and years ahead.

WELSH DEVOLUTION

1.80 The extent to which leasehold enfranchisement is devolved to the Welsh Assembly is unclear. Aspects of enfranchisement have, in the past, been treated as a devolved issue. “Housing” was expressly devolved to Wales in the Government of Wales Act

---

21 See n 5 above.


24 The Housing and Planning Act 2016, s 136 and sch 10, confers a power to make regulations governing minor intermediate leasehold interests for the purposes of the enfranchisement legislation (namely the 1967 Act)
Following the Wales Act 2017, rather than expressly devolving competence in certain areas, competence is devolved unless expressly reserved. The Welsh Assembly cannot modify “the private law”, which includes the law of property. But that does not apply if the modification “has a purpose (other than modification of the private law) which does not relate to a reserved matter”.26

Under our Protocol with the Welsh Ministers, the Commission will only undertake a project concerning a matter that is devolved to Wales if it has the support of the Welsh Ministers.27 To the extent that any of the matters in our Terms of Reference are devolved to Wales, the Welsh Ministers have indicated their support for the Commission undertaking this project.

Our project, therefore, is intended to cover both England and Wales, and to result, where reasonably possible, in a uniform set of recommendations that are suitable for both England and Wales. We asked consultees whether any specific considerations call for particular issues to be treated differently in England and in Wales. Some consultees commented that property values are different in Wales when compared to parts of England (in particular London) and that valuations under the “original valuation basis” are perhaps more common in Wales than in parts of England (in particular London). But no suggestions from consultees led us to conclude that a reformed enfranchisement regime should adopt a different approach in England and in Wales.

STRUCTURE OF THIS REPORT

In Chapter 2, we explain how enfranchisement premiums are calculated under the current law by reference to four worked examples, which we use throughout this report. First, we explain the valuation methodology, introducing the various concepts that are involved. Second, we explain the process by which enfranchisement premiums are agreed by the parties or determined by the Tribunal. We explained above (at paragraph 1.30) that there are two bases of valuation, and our focus in this chapter (and Chapters 5 to 8) is on the “mainstream valuation basis”. We discuss the “original valuation basis” in Chapter 9.

In Chapter 3, we consider the arguments for and against reforming the regime governing the calculation of enfranchisement premiums. We explain the arguments that we have heard about whether leasehold ownership is inherently unfair, the problems with the current law, and the arguments for and against reducing premiums (as required by our Terms of Reference).


26 Wales Act 2017, s 3 and sch 1 and 2 (and the new sch 7A and 7B).
1.85 In Chapter 4, we comment on our role in reforming the valuation regime – both what we are doing, and what we are not doing.

1.86 In Chapters 5 and 6, we set out the options for reducing premiums and for improving the enfranchisement valuation process. We split our explanation of the options into two parts: (1) “schemes”, and (2) “sub-options” for reform. There are three alternative options for an overall “scheme” which could be adopted. They would set the general framework for the reformed enfranchisement valuation regime. We explain those three alternative schemes in Chapter 5. Then in Chapter 6, we discuss various “sub-options” which could be incorporated within one of those three overall valuation schemes. Whichever “scheme” is adopted, one, some, or all of the “sub-options” could be adopted within it.

1.87 After setting out the schemes, and the sub-options, we then pause to consider – in Chapter 7 – the potential role of an online calculator in ascertaining enfranchisement premiums. Depending on which sub-options are adopted from Chapter 6, it would be possible for an online calculator to be made available which would tell leaseholders and landlords – in certain circumstances – what the enfranchisement premium will be.

1.88 In Chapter 8, we draw together the schemes (from Chapter 5) and the sub-options (from Chapter 6) to summarise how they relate to each other and which could work together.

1.89 Finally, in Chapter 9, we discuss the original valuation basis in section 9(1) of the 1967 Act (see paragraph 1.30 above) and set out the options for how that basis of valuation could be reformed. We explain the difficulties we have encountered in replacing section 9(1) with a simplified, updated equivalent provision in that we have not been able to identify a way to simplify section 9(1) which ensures that all – and only – those leaseholders who currently benefit from section 9(1) would continue to do so, or which ensures that qualifying leaseholders would pay exactly the same premiums as they currently do. We put forward two possible options for Government: first, retaining section 9(1) largely in its current form, and secondly, introducing an entirely new scheme to replace 9(1) and to provide a more favourable valuation basis to assist leaseholders of low value properties to enfranchise.

1.90 In Chapter 10, we gather together all of the options for reform set out in this report.

1.91 We list those who responded to the Consultation Paper in Appendix 1, and we set out our Terms of Reference in Appendix 2. Throughout this report, we use four worked examples to demonstrate the effect that the various options for reform would have on the enfranchisement premium payable. In Appendix 3, we set out the detailed calculations for those worked examples. Appendix 4 sets out some modelling that is relevant to our discussion of the original valuation basis in Chapter 9.

**SUMMARY OF THE OPTIONS FOR REDUCING PREMIUMS IN THIS REPORT**

1.92 We set out three alternative options for a new regime to calculate premiums. Within each of those three regimes, there is a series of further sub-options for reform. Depending on which options for reform are pursued, it would be possible to create an online calculator for the calculation of premiums. A diagram representing the options and sub-options, and the relationship between them, is provided at page 22.
PUBLICATIONS ACCOMPANYING THIS REPORT

1.93 Alongside this Report, we have published on our website:28

(1) Counsel’s Opinion, concerning the compatibility with A1P1 of the options for reform set out in this report, together with our instructions to Counsel; and

(2) In so far as the consultation responses we received responded to our questions about valuation:

(a) a statistical summary of how consultees responded to the questions; and

(b) the consultation responses themselves.

1.94 A statistical summary of consultees’ responses to the remaining questions in the Consultation Paper, and the consultation responses themselves, will be published alongside our second report, to be published later this year.

ACKNOWLEDGEMENTS

1.95 Our thanks go to all those who responded to our Consultation Paper (listed in Appendix 1) or who have supported our project in other ways. We are grateful for the work, time and careful thought they have given to the detailed issues covered in this report. We are also grateful to those who have organised and hosted consultation events which enabled us to engage with a wide range of stakeholders.

THE PROJECT TEAM

1.96 The Commissioners would like to record their thanks to the following members of staff who worked on this report: Matthew Jolley (team manager); Daniel Robinson (lead lawyer); Ellodie Gibbons (team lawyer); Charlotte Black (team lawyer); Frances Joyce (consultant valuer); Caoimhe McKearney (team lawyer); Kevin Pain (team lawyer); Emily Fitzpatrick (team lawyer); Thomas Nicholls (legal assistant); Jonathan Mellor (legal assistant); Liam Davis (research assistant) and Harley Ronan (research assistant).

---

28  Available at https://www.lawcom.gov.uk/project/leasehold-enfranchisement/.
Chapter 2: Calculating premiums under the current law

INTRODUCTION

2.1 In this chapter, we explain how premiums are calculated under the current law.

(1) First, we consider the valuation methodology: what is the method by which premiums are assessed? We focus on the mainstream valuation basis which applies to all flats and many houses: see paragraph 1.30. The original valuation basis is discussed separately in Chapter 9, though it shares some of the features of the methodology of the mainstream valuation basis.

(2) Second, we consider how the process of valuation works in practice, from the commencement of the claim through to the completion of the claim. This discussion applies to both the mainstream valuation basis and the original valuation basis.

2.2 Throughout this report, we use four hypothetical enfranchisement claims to demonstrate the effect that the various options for reform might have on the premium payable. They are all claims to purchase the freehold of a house, but as we go on to explain below the same principles apply to a lease extension of a flat or the freehold purchase of a block of flats.\(^29\) The examples are set out in Figure 3 below. The detailed calculations on which they are based are set out in Appendix 3.

<table>
<thead>
<tr>
<th>Figure 3: four examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House 1</strong></td>
</tr>
<tr>
<td>Value on a freehold basis: £250,000</td>
</tr>
<tr>
<td>Valuation date: 2019</td>
</tr>
<tr>
<td>Details of existing lease:</td>
</tr>
<tr>
<td>Granted in 1995 for 125 years</td>
</tr>
<tr>
<td>Unexpired term: 101 years</td>
</tr>
<tr>
<td>Value of lease: £245,000(^{30})</td>
</tr>
<tr>
<td>Ground rent: £50 per annum, increasing</td>
</tr>
<tr>
<td>by £50 every 25 years:</td>
</tr>
<tr>
<td>- £50 per annum from 1995</td>
</tr>
<tr>
<td>- £100 per annum from 2020</td>
</tr>
<tr>
<td>- £150 per annum from 2045</td>
</tr>
<tr>
<td>- £200 per annum from 2070</td>
</tr>
<tr>
<td>- £250 per annum from 2095</td>
</tr>
</tbody>
</table>

\(^{29}\) The difference is that in a lease extension claim, there is an additional stage of calculating the value of the reversion after the extension. The premium is then the difference between the value of the reversion (i) before and (ii) after the lease extension. In a freehold purchase claim, the landlord does not retain any interest and so it is only necessary to calculate the value of the reversion before the claim.

\(^{30}\) Existing lease value is based on guidance in *Contractreal Ltd v Smith* [2017] UKUT 178 (LC), at [70], and *Earl Cadogan v Erkman* [2011] UKUT 90 (LC).
**House 2 (which we refer to as “House A” in the Summary)**

Value on a freehold basis: £250,000  
Valuation date: 2019

<table>
<thead>
<tr>
<th>Details of existing lease:</th>
<th>After freehold purchase:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Granted in 1995 for 100 years</td>
<td>No lease</td>
</tr>
<tr>
<td>Unexpired term: 76 years</td>
<td>No ground rent</td>
</tr>
<tr>
<td>Value of lease: £226,250*31</td>
<td>Value of freehold: £250,000</td>
</tr>
<tr>
<td>Ground rent: £50 per annum, increasing by £50 every 25 years:</td>
<td></td>
</tr>
<tr>
<td>- £50 per annum from 1995</td>
<td></td>
</tr>
<tr>
<td>- £100 per annum from 2020</td>
<td></td>
</tr>
<tr>
<td>- £150 per annum from 2045</td>
<td></td>
</tr>
<tr>
<td>- £200 per annum from 2070</td>
<td></td>
</tr>
</tbody>
</table>

**House 3**

Value on a freehold basis: £250,000  
Valuation date: 2019

<table>
<thead>
<tr>
<th>Details of existing lease:</th>
<th>After freehold purchase:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Granted in 2010 for 250 years</td>
<td>No lease</td>
</tr>
<tr>
<td>Unexpired term: 241 years</td>
<td>No ground rent</td>
</tr>
<tr>
<td>Value of lease: £247,500*32</td>
<td>Value of freehold: £250,000</td>
</tr>
<tr>
<td>Ground rent: - £300 per annum, increasing in line with the Retail Prices Index (“RPI”) every 10 years</td>
<td></td>
</tr>
</tbody>
</table>

**House 4**

Value on a freehold basis: £250,000  
Valuation date: 2019

<table>
<thead>
<tr>
<th>Details of existing lease:</th>
<th>After freehold purchase:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Granted in 2010 for 250 years</td>
<td>No lease</td>
</tr>
<tr>
<td>Unexpired term: 241 years</td>
<td>No ground rent</td>
</tr>
<tr>
<td>Value of lease: £247,500*33</td>
<td>Value of freehold: £250,000</td>
</tr>
<tr>
<td>Ground rent: - £300 per annum doubling every 10 years for 50 years</td>
<td></td>
</tr>
</tbody>
</table>

---

31 Existing lease value is based on the Gerald Eve 1996 graph of unenfranchisable relativities, available at www.geraldeve.com/services/leasehold-enfranchisement. See further para 2.44 onwards below.

32 Existing lease value is based on guidance in *Contractreal Ltd v Smith* [2017] UKUT 178 (LC), at [70], and *Earl Cadogan v Erkman* [2011] UKUT 90 (LC). If the lease was under 80 years, and marriage value payable, it would be subject to an onerous ground rent adjustment. See further n 44 below.

33 Existing lease value is based on guidance in *Contractreal Ltd v Smith* [2017] UKUT 178 (LC), at [70], and *Earl Cadogan v Erkman* [2011] UKUT 90 (LC). If the lease was under 80 years, and marriage value payable, it would be subject to an onerous ground rent adjustment. See further n 44 below.
2.3 All four examples are fictitious leases that have been designed to be easily compared with each other. They have been chosen in order to demonstrate as simply as possible the valuation process and our options for reform, whilst still reflecting the sorts of terms that are found in real leases in the market.

(1) We have not made any assumptions about what are typical terms of leases in the market, so our examples are not intended to be representative of all leases in the market. For example, House 4 is a lease with a doubling ground rent. Such leases have been the subject of much attention in the media, by Government, and in Parliament. There is no consensus between landlord and leaseholder groups as to how many leases with doubling ground rents exist in the market, but on any view they comprise a relatively small proportion – albeit an important proportion – of all leases. Nevertheless, we think it is important that reform takes account of these leases, because of the particularly severe impact the doubling ground rents have on the leaseholders. Indeed one of our options for reform is devoted to assisting leaseholders who have leases with doubling (or other onerous) ground rents.\textsuperscript{34} Our inclusion of House 4 as a worked example therefore allows us to demonstrate how that option for reform would operate in practice.

(2) Nor do our worked examples demonstrate what premium would in fact be payable in such a claim; much will depend on the particular facts, on the parties’ professional advisers, on the parties’ negotiating positions and willingness (or financial ability) to argue the case before the Tribunal. This uncertainty about enfranchisement premiums is one of the arguments for reform, which we discuss further in Chapter 3.

(3) We use a freehold value of £250,000 in all worked examples since that is a round figure that is close to average house prices in the UK.\textsuperscript{35}

2.4 We use the worked examples to demonstrate the two most common enfranchisement claims under the current law, namely:

(1) the right to acquire the freehold of a house; and

(2) the right to a lease extension of a flat, which provides the leaseholder with a new lease which is 90 years longer than the current lease (so it “extends” the lease by 90 years),\textsuperscript{36} and under which the ground rent is a peppercorn (in place of whatever the ground rent is under the existing lease). Although the worked examples are freehold house purchases, the principles apply equally to lease extensions of a flat.\textsuperscript{37}

\textsuperscript{34} See para 6.119 onwards.

\textsuperscript{35} As of September 2019, the average UK house price was £234,370: see \textit{HM Land Registry UK House Price Index}, available at https://landregistry.data.gov.uk/app/ukhpi.

\textsuperscript{36} Strictly speaking, the lease is not extended; rather, the old lease is surrendered and a new lease of a longer term is granted in its place. Nevertheless, the phrase “lease extension” is commonly used and we adopt it in the Report.

\textsuperscript{37} See n 29 above.
2.5 There are two additional enfranchisement rights. First, there is a right to a 50-year lease extension of a house.\(^{38}\) This right is not often exercised. There is no premium payable for a lease extension of a house. Instead, the extended term of the lease is subject to what is called a “modern ground rent”. Essentially, what the leaseholder saves by not paying a premium he or she pays by way of rent over the extended 50-year term of the lease. We explain the calculation of the modern ground rent in paragraph 9.15 below. We have provisionally proposed replacing the current right to a lease extension of a house with a lease extension right like that available for flats. We do not discuss the existing right any further in this report.

2.6 Second, there is a right to acquire the freehold of a block of flats collectively.\(^{39}\) The principles that apply to a lease extension of individual flats apply equally to the freehold acquisition of a block of flats. However, there are some additional considerations when a block is acquired but some leaseholders do not participate in the collective enfranchisement claim, or in a claim where there is development, or other additional, value involved. We discuss those particular considerations later in this report, but for the purposes of providing worked examples, the same principles apply.

2.7 In the Consultation Paper, we provisionally proposed moving away from the distinction in the current law between houses and flats. We proposed instead the same lease extension rights for all residential units, and for freehold purchase rights to be available in respect of all residential units either by an individual leaseholder (where there is one residential unit in the building) or by a group of leaseholders (where there are two or more residential units in the building).\(^{40}\)

(A): THE CURRENT VALUATION METHODOLOGY

2.8 We set out a detailed explanation of how premiums are calculated under the current law in Chapter 14 of the Consultation Paper. We do not repeat that explanation in this Report. Instead, we summarise how the current law operates using the four worked examples.

2.9 Our explanation of the current law is based on the mainstream valuation basis.

(1) In the case of flats, the mainstream valuation basis applies to all claims – both lease extension claims and claims for the collective purchase of a block of flats.

(2) In the case of houses, the mainstream valuation basis applies to many claims to purchase the freehold. Other claims, however, qualify for valuation under the original valuation basis, which results in lower premiums for leaseholders. These claims are considered separately in Chapter 9.

2.10 The basic principle underpinning the mainstream valuation approach is that the landlord is to be paid the market value for the interest the landlord has that will be acquired by the leaseholder – in other words, the freehold interest (in the case of the freehold

\(^{38}\) Enfranchisement Consultation Paper (“Enfranchisement CP”), para 4.4 onwards.

\(^{39}\) Enfranchisement CP, ch 6.

\(^{40}\) Enfranchisement CP, paras 4.38 to 4.41.
purchase of a house) or an additional 90 years added to the existing lease (in the case of a lease extension of a flat).

2.11 The market value of the landlord’s interest is assessed with the input of expert valuers. We discuss their role in the second part of this chapter (paragraph 2.63 onwards). If the market value cannot be agreed by the parties’ valuers, the market value must be determined by the Tribunal. The enfranchisement legislation does not dictate precisely how valuers, and ultimately the Tribunal, should assess the market value of the landlord’s interest. The conventional valuation approach, which is used by valuers and the Tribunal in almost all enfranchisement claims, is to assess the market value by reference to different components of the landlord’s interest. We explain the three main components below, by reference to the worked examples. As we go on to explain below, however, valuers might in some circumstances assess the market value of the landlord’s interest using a different valuation methodology: see paragraph 2.61.

(1) The “term”
Replacing the ground rent income with a capital sum

2.12 The result of an enfranchisement claim is that the landlord will no longer receive the ground rent income during the term of the existing lease.

(1) For House 1, the landlord loses the right to receive the ground rent of £50 per annum (rising to £250 per annum) over the remaining 101 years of the lease.

(2) For House 2, the landlord loses the right to receive the ground rent of £50 per annum (rising to £200 per annum) over the remaining 76 years of the lease.

(3) For House 3, the landlord loses the right to receive the ground rent of £300 per annum (rising in line with RPI) over the remaining 241 years of the lease.

(4) For House 4, the landlord loses the right to receive the ground rent of £300 per annum rising to £9,600 per annum) over the remaining 241 years of the lease.

2.13 In a freehold purchase claim, the landlord no longer receives any ground rent. In a lease extension claim, the “term” is not strictly lost since the landlord continues to receive a ground rent, but as the ground rent is reduced to a peppercorn, the landlord loses the existing value of the term.

2.14 To compensate the landlord for the loss of ground rent income, the future rent is “capitalised”. In other words, the value of that income stream is assessed to determine what capital sum the landlord needs to receive on the valuation date to replace the income stream represented by the rent being paid over time. This valuation is achieved by applying a capitalisation or yield rate: see Figure 4 below.

2.15 Capitalising a ground rent is one example of the process of capitalising a future income stream, which is done in other contexts. For example, an equivalent task is undertaken by actuaries when they assess the current value of the future liabilities of a pension fund, and by economists when they assess the current value of future costs and benefits arising from certain actions.
2.16 Once a capitalisation rate has been selected, it is converted into a “multiplier” (called a “Years Purchase” (YP) multiplier, which is calculated based on (a) the capitalisation rate, and (b) the number of years remaining on the lease). The only variable is the capitalisation rate itself. Once that rate is established, converting it into a premium is simply a mathematical calculation – which is uncontroversial, relatively easy, and could be done through an online calculator (on which see Chapter 7 below).

Future rent reviews

2.17 Where there are future rent reviews under a lease which will result in the ground rent increasing, account needs to be taken of the fact that the landlord has no immediate right to that increased rental stream. The landlord’s right to any increase in rent that would follow a rent review is “deferred” as it would not be received until a future date. Consequently, a deferment rate is needed to calculate the present value of that future entitlement (we explain deferment rates further in paragraph 2.34 onwards below). So for House 1, the landlord is currently entitled to a ground rent of £50 per annum, but from 2020 that entitlement will go up to £100 per annum, and from 2045 it will go up to £150 per annum, and so on. The landlord’s future entitlement to £100 per annum, then £150, and so on, is taken into account, but it is deferred to reflect the fact that the landlord will receive a capital sum now in respect of an increased rent which would only have been payable from a future date.

2.18 This process of deferring the increased ground rent income is relatively straightforward when it is known what the future rent will be (as in Houses 1, 2 and 4). But in many cases it will be known that the ground rent will increase, but the amount of the increase will not be known. For example, the lease might provide for the ground rent to be reviewed to a level which is (say) 0.1% of the value of the property on the review date, or to increase in line with the Retail Prices Index (as in House 3). Since it is not possible to know what the level of the rent will be, it is not possible to calculate that future rent and defer it. As a consequence, valuers instead (a) calculate what the rent would be if it were subject to review on the valuation date, (b) use that level of rent in their calculation, and (c) use a lower capitalisation rate to reflect the fact that the rent is, to some or other extent, inflation-proof. The result is a higher enfranchisement premium.

Selecting the capitalisation rate

2.19 The capitalisation rate to adopt in an enfranchisement calculation depends on the facts of the case, and different valuers will have different views on the appropriate rate. Valuers will look at market evidence about how investors generally are investing their money and the returns that they receive from those investments, in order to arrive at a rate that is appropriate for the particular income stream that they are valuing.

2.20 The capitalisation rate reflects the “quality” of the income stream from the recipient’s point of view. The better the ground rent income stream, the lower the capitalisation rate (and the higher the enfranchisement premium).

---

41 When a deferment rate is used in this way, by convention the capitalisation and deferment rates will be the same.
2.21 Accordingly, the appropriate capitalisation rate will depend, for example, on:

(1) **the level of the ground rent.** A ground rent of £300 per annum is more attractive to investors on a pound-for-pound basis than an income of £30 per annum, since (for example) the administrative cost of collecting the income is proportionately lower. So a ground rent of £300 per annum will usually be capitalised at a lower rate than a ground rent of £30 per annum. The result is that the premium for the £300 per annum ground rent is more than ten times higher than the premium for the £30 per annum ground rent because (a) the level of the rent itself is ten times higher, but (b) the capitalisation rate applied to the £300 ground rent is different, and so makes the premium higher.

(2) **the rent review provisions in the lease.** Ground rents may be:

(a) “fixed” (or “static”), for example, a ground rent of £300 per annum;

(b) subject to a simple review, for example, a ground rent which increases by £50 per annum every 25 years (as with Houses 1 and 2); or

(c) subject to a “dynamic” review, for example a ground rent that increases at frequent intervals, or that increases in line with the Retail Prices Index, or is linked to capital or rental values (as with Houses 3 and 4).

A ground rent which is inflation-proof to some degree because it increases over time is more attractive to investors than a ground rent that is fixed over time. So a ground rent that is subject to review, particularly a dynamic review, will usually be capitalised at a lower rate than a static ground rent, resulting in a higher premium. There is a wide range of different types of ground rent review. Each, arguably, justifies a different capitalisation rate, because they are of variable attractiveness to investors.

(3) **reliability of payment and cost of collection and enforcement.** An income stream from hundreds of flats in a good-quality, newly-built estate in a popular location will be more attractive to an investor than an individual dilapidated house in an unpopular location.

### Selecting the capitalisation rate: the effect of high ground rents

2.22 The way in which “the term” is valued poses particular problems for leaseholders with high ground rents (including – but not limited to – onerous ground rents, such as those that double every 10 years). That is for two cumulative reasons.

(1) First, a ground rent which is high (even if fixed) will, automatically, result in a higher premium, even if the same capitalisation rate is used. For example:

(a) a (fixed) ground rent of £150 per annum for 70 years capitalised at 6% would be £2,458; whereas

(b) a (fixed) ground rent of £300 per annum for 70 years capitalised at 6% would be £4,915.
(2) Second, a high ground rent or a ground rent that is “dynamic” will command a lower capitalisation rate, resulting in a higher premium. For example:

(a) a ground rent of £300 per annum which doubles every 10 years over 70 years capitalised at 6% would amount to £22,058; whereas

(b) a ground rent of £300 per annum which doubles every 10 years over 70 years capitalised at 4% would amount to £50,034.

2.23 So the valuation of an already high ground rent is compounded by the use of a lower-than-usual capitalisation rate. Leaseholders with high ground rents (including those with ground rents that double every 10 years, or with ground rents that are otherwise onerous) are faced with the fact that the ground rent being capitalised is already high, and the capitalisation itself is done using a lower rate. Accordingly, for leaseholders with high ground rents, the way in which “the term” is valued under the current law results in their enfranchisement premiums being very significantly higher than for leaseholders with lower, fixed or more moderate ground rents.

2.24 As we go on to explain below (in paragraph 2.49 and 2.50, there is in fact a third compounding factor for leaseholders with high ground rents because the value of their existing lease will be lower, which results in the third part of the enfranchisement premium (the marriage value) being higher as well.

Selecting the capitalisation rate in our examples

2.25 Given that the capitalisation rate will depend on the details of the lease, and on various other factors, we have used rates in our examples which might, in appropriate cases, be used as the capitalisation rate. Given the high level of the ground rent for Houses 3 and 4, it is likely that a lower capitalisation rate would be used than for Houses 1 and 2. For the purposes of explanation, we have selected a capitalisation rate of 6% for Houses 1 and 2, and a capitalisation rate of 4% for Houses 3 and 4. In Chapter 3, we explain how those premiums would differ if the capitalisation rates selected were 1% higher or 1% lower (see paragraph 3.35 and Figure 15).

2.26 We are not suggesting that those rates would or should be used for these leases. We have provided the worked examples in order to aid our explanation of our options for reducing premiums in this Report.

2.27 Figure 4 below sets out how “the term” might be valued for Houses 1, 2, 3 and 4. The detailed calculations are set out in Appendix 3.

<table>
<thead>
<tr>
<th>Figure 4: Calculation of the “term” for Houses 1, 2, 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House 1:</strong> The current value of the right to receive £50 per annum rising to £250 per annum over the next 101 years of the lease based on a capitalisation rate of 6% is £1,844.</td>
</tr>
<tr>
<td><strong>House 2:</strong> The current value of the right to receive £50 per annum rising to £200 per annum over the next 76 years of the lease based on a capitalisation rate of 6% is £1,806.</td>
</tr>
<tr>
<td><strong>House 3:</strong> The current value of the right to receive £300 per annum, increasing in line with RPI every 10 years of the term, for the remaining 241 years of the lease based on a capitalisation rate of 4% is £9,554.</td>
</tr>
</tbody>
</table>
House 4: The current value of the right to receive £300 per annum, doubling every 10 years for the first 50 years of the term, for the remaining 241 years of the lease based on a capitalisation rate of 4% is £79,422.

(2) The “reversion”

2.28 The landlord loses the right to have the property back at the expiry of the lease, which is referred to as the landlord’s “reversion”.

(1) For House 1, the landlord loses the right to have the property back in 101 years.

(2) For House 2, the landlord loses the right to have the property back in 76 years.

(3) For Houses 3 and 4, the landlord loses the right to have the property back in 241 years.

2.29 In a freehold purchase claim, the landlord loses the right to have the property back altogether. In a lease extension claim, the landlord’s right to have the property back is delayed by a further 90 years.

2.30 The valuation of the reversion seeks to compensate the landlord for the value today of the right to have the property back (the right to have “vacant possession”) at the expiry of the lease. The landlord receives a sum of money which is meant to be equivalent to the value of that right.

2.31 Two inputs are required in order to value the reversion:

(1) the freehold vacant possession (“FHVP”) value of the property; and

(2) a deferment rate.

Freehold vacant possession (FHVP) value

2.32 The FHVP value is usually calculated by ascertaining the value of the property if it were to be sold on a long lease, and adjusting the long lease value to arrive at a freehold value. We describe the process in detail in paragraphs 14.32 to 14.46 of the Consultation Paper.

(1) Ascertaining the value of the property is a relatively familiar concept to home-owners. In a discussion between an estate agent and a prospective buyer or seller of a flat, it is the answer to the question: “how much is the flat worth?”. It is usually assessed by looking at comparable properties that have sold in the market: the sale price of the comparable property is adjusted to reflect any differences between the property and the comparable property.

(2) Adjusting that long lease value to arrive at the FHVP value requires the use of a “relativity percentage”. The relativity percentage is the value of a leasehold interest in a property relative to the value of the same property were it to be held freehold. We discuss relativity in the context of marriage value at paragraphs 2.44 to 2.47 below. In the marriage value calculation, relativity is used to calculate the value of the short existing lease relative to the freehold value of the property. However, a long lease of a property will also be worth less than the same property held freehold and have a value relative to it. When calculating the short lease
value, the relativity percentage is applied to the FHVP value. When calculating the FHVP value, the calculation can be done in reverse: a relativity percentage can be used in combination with the known (long) lease value in order to ascertain the FHVP value. It is generally accepted that the appropriate relativity in this context is:

(a) 98% for leases with unexpired terms of 100 to 114 years;
(b) 98.5% for leases with unexpired terms of 115 to 129 years; and
(c) 99% for leases with unexpired terms of above 130 years.42

2.33 Taking our worked examples.

(1) for House 1, the value of the 101-year leasehold interest is £245,000, and the relativity is 98%, so the value of the freehold interest in the property is £250,000.

(2) for House 2 the value of the 76-year leasehold interest is £226,250, and the relativity is 90.5%, so the value of the freehold interest in the property is £250,000.43

(3) for Houses 3 and 4, the value of the 241-year leasehold interest is £247,500, and the relativity is 99% (ignoring the onerous ground rent44), so the value of the freehold interest in the property is £250,000.

The deferment rate

2.34 The landlord is not entitled to have the property back until the end of the lease. The benefit of the FHVP value of the property is therefore “deferred”. A deferment rate is used to calculate a capital sum which, if invested now, would provide a value equivalent to the FHVP value as at the expiry of the lease.

2.35 When discussing capitalisation rates above,45 we explained that capitalising a ground rent income was an example of the process of capitalising a future income stream, which is also done in other contexts. The same can be said of deferment rates: there are other contexts in which an assessment has to be made of the current value of a future entitlement. Indeed, there are similarities between the process of valuing the term (using a capitalisation rate) and valuing the reversion (using a deferment rate). Both involve ascertaining the value of a future entitlement, albeit that future entitlement is very different in both cases. The reversion is (in effect) an entitlement to a substantial

---

42 Contractreal Ltd v Smith [2017] UKUT 178 (LC), at [70], referring to Earl Cadogan v Erkman [2011] UKUT 90 (LC).

43 The relativity of 90.5% is taken from the Gerald Eve 1996 graph of unenfranchiseable relativities, available at www.geraldeve.com/services/leasehold-enfranchisement. See further para 2.45 onwards below.

44 These houses would have been bought at a relativity of 99% or 100%, which ignored the onerous ground rent. Since then, potential purchasers have become aware of the huge enfranchisement premiums payable to acquire the freeholds. Consequently, the leases of the houses are now only worth £250,000 less the enfranchisement premium of, say, £79,417 as per our example. This is £170,583, which is 68.23% of the £250,000 freehold value. However, for the purposes of our examples, our method has been to ignore the onerous ground rent.

45 Para 2.15.
single capital sum (the enjoyment of vacant possession of the property) due to be received some time in the future, whereas the term is an entitlement to smaller recurring sums for a fixed period. Since the nature of the two entitlements (a capital asset and an income stream) is different, they are attractive to different types of investor, and the rates used are therefore different too.

2.36 Once a deferment rate has been selected, it is possible to calculate the present value ("PV") of £1 on the expiry of the lease at that rate. The only variable is the deferment rate itself. Once that rate is established (and the FHVP value is known), converting it into a premium is simply a mathematical calculation – which is uncontroversial, relatively easy, and could be done through an online calculator (on which see Chapter 7 below).

2.37 In Sportelli, the Tribunal decided that in Prime Central London, the generic deferment rate for leases with at least 20 years left to run was 4.75% for houses, and 5% for flats. Different rates can be adopted for shorter leases, and for leases in other parts of England and Wales.

2.38 Figure 5 below sets out how “the reversion” might be valued for Houses 1, 2, 3, and 4, assuming the rates in Sportelli are adopted. The detailed calculations are set out in Appendix 3.

2.39 In Chapter 3, we explain how those premiums would differ if the deferment rate selected were 1% higher or 1% lower (see paragraph 3.35 and Figure 15).

<table>
<thead>
<tr>
<th>Figure 5: Calculation of the “reversion” for Houses 1, 2, 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House 1:</strong> The current value of the right to receive £250,000 in 101 years based on a deferment rate of 4.75% is £2,303.</td>
</tr>
<tr>
<td><strong>House 2:</strong> The current value of the right to receive £250,000 in 76 years based on a deferment rate of 4.75% is £7,349.</td>
</tr>
<tr>
<td><strong>House 3:</strong> The current value of the right to receive £250,000 in 241 years based on a deferment rate of 4.75% is £3.</td>
</tr>
<tr>
<td><strong>House 4:</strong> The current value of the right to receive £250,000 in 241 years based on a deferment rate of 4.75% is £3.</td>
</tr>
</tbody>
</table>

(3) Marriage value

2.40 It is an observed fact that, if the value of the lease of a particular property is £x and the value of the associated reversion is £y, the value that the same property would command if held on a freehold basis with vacant possession will be greater than £x+y. Marriage value is the amount by which it is greater. In other words, it is the additional value an interest in land gains when the landlord’s and the leaseholder’s separate interests are "married" into single ownership. The aggregate value of those two interests

---

46 Earl Cadogan v Sportelli [2007] 1 EGLR 153. The determination of the deferment rate was appealed to the Court of Appeal (Earl Cadogan v Sportelli [2007] EWCA Civ 1042, [2008] 1 WLR 2142). However, that part of the appeal was dismissed so the Tribunal’s decision still stands. There was a further appeal to the House of Lords, but the determination of the deferment rate did not form part of that appeal.
held separately is often significantly less than the value if they are both held by the same person.

2.41 To take an analogy, a pair of Chinese vases are worth more as a pair than the sum of their individual values. The amount by which they are worth more is marriage value. That value can be realised either by sale (to the person with the other vase) or by purchase (of the other vase).

2.42 Applying the above to a landlord and leaseholder, if the lease is one Chinese vase and the freehold is its pair, when the leaseholder gains the freehold he or she gains the enhanced value from having a pair of vases: the marriage value. Because the leaseholder, unlike any other potential purchaser, will gain that value on purchasing the freehold, he or she is likely to outbid anyone else in the market. It is assumed in the valuation regime that the leaseholder will overbid half of the total marriage value.

2.43 We explain marriage value in more detail in paragraphs 14.53 to 14.69 of the Consultation Paper. In summary, where a lease has more than 80 years unexpired, the legislation provides that no marriage value is payable by the leaseholder. That reflects an assumption that marriage value is insignificant where the lease has more than 80 years left to run. Where marriage value is payable to the landlord (because the lease has 80 years or less left to run), the legislation requires the leaseholder to pay half of the marriage value; that reflects an assumption that the leaseholder would overbid half of the marriage value, thus giving the landlord half and acquiring half for himself or herself.

2.44 To calculate marriage value, it is necessary to establish the value of the existing lease. For consistency, the statutory assumptions that apply when assessing the FHVP value also apply when assessing the value of the existing lease. In particular, the legislation provides that it has to be assumed that the leaseholder’s statutory enfranchisement right does not exist. This assumption creates a problem for the valuer because the potential comparables – short leases (that is, leases of less than 80 years) being sold in the market – nearly all have the benefit of enfranchisement rights. There are two ways in which the valuer may approach this problem:

(1) find the real-world value of a short lease (by reference to comparables) and then deduct from this the estimated value of the benefit of enfranchisement rights – this approach is referred to as the “no-Act deduction” or “a deduction for Act rights”; or

(2) use a graph of relativity: see Figure 6.

The exceptions are in the cases of very short or very long existing leases where the separate values will be worth more than the value of the interests married together (and so in this situation marriage value will be a negative rather than a positive value).

1967 Act, s 9(1E); 1993 Act, schs 6 and 13, para 4(2A).

1967 Act, s 9(1D); 1993 Act, schs 6 and 13, para 4(1).


1967 Act, s 9(1A)(a); 1993 Act, sch 6, para 3(1)(b).
As explained at paragraph 2.32(2) above, relativity is the value of a property sold on a lease relative to its freehold value. Various organisations, predominantly firms of valuers, have devised graphs of relativity. To do this they have taken a data set, for example, settlements reached on enfranchisement claims, and plotted the relativities derived from that data set on a graph where the horizontal axis shows the length of the lease and the vertical axis shows the value of that lease relative to the freehold value of the same property expressed as a percentage, “the relativity”.

For example, if the data set being used is settlements and a particular settlement shows that the freehold value of a property was agreed to be £100,000 and the value of the property held on an existing lease with 63 years remaining was agreed to be £83,000 (that is, 83% of the freehold value), that relativity of 83% would be plotted on the graph at 63 years.

Having plotted all the relativities derived from the data set, a curve is drawn through the coordinates to link them. This means that anyone reading the graph can derive a relativity for any given lease length.

Neither of the approaches set out at paragraph 2.44 above is without its difficulties:

(1) the no-Act deduction is arguably arbitrary in the absence of evidence, which we discuss further in paragraph 3.17 onwards below; and

(2) a number of different graphs of relativity have been devised, and there is no consensus as to which graph ought to be used: see Figure 7.

We discuss the problems associated with the uncertainty in Chapter 3.

In The Trustees of the Sloane Stanley Estate v Mundy, the Upper Tribunal considered the method which is generally to be used in order to value an existing lease of a flat on the assumption that the existing lease of the relevant flat does not have Act rights. In particular, it was asked to consider the use of the “Parthenia model” to calculate relativity. The Parthenia model was based upon sales of properties between 1987 and 1991 – that is, before the distortion of the market caused by the Leasehold Reform, Housing and Urban Development Act 1993 (“the 1993 Act”) and the prospect of the 1993 Act being brought into force. That data was then analysed using a statistical technique known as “hedonic regression”, a technique which extrapolates the effect of the lease length on the value of the lease.

The Mundy case is significant because when the Parthenia model was used to value the short leases in that case, it produced lower premiums for the lease extensions than the more commonly used relativity graphs. It is therefore claimed by Parthenia that use of its model is a

---

52 For example, the Gerald Eve graph is based on settlements reached on enfranchisement claims between 1974 and 1996. We discuss the Gerald Eve graph further in Figure 7 below.


54 The price of a property is the sum of the value of its different attributes, such as size and location. Regression is the breakdown of that price to find the value of an individual attribute of interest, in this case the value attributable to lease length. That individual attribute is known as the “hedonic” attribute.
way of reducing the premium payable by leaseholders to enfranchise. However, the model was rejected by the Upper Tribunal.

The main problem that the Upper Tribunal found with the Parthenia model was that it produced an impossible result. In the case of one of the flats, the value of the lease in the real world (with rights under the Act) was agreed at £2m. It was also agreed that a lease with rights under the Act was more valuable than a lease without rights under the Act. However, the Parthenia model produced a higher figure of £2.2m for the same lease without rights under the Act. The Upper Tribunal described the Parthenia model as “a clock that struck 13”: “Even if the application of the model produced an answer in another case which was not impossible, that does not mean that the model has been shown to be reliable. If a clock strikes 13, it is broken. It is not a reliable time piece. It cannot be relied upon as a reliable means of telling the time even when it strikes an hour, such as 11 or 12, which are possible times of day.”

The Tribunal heard a substantial amount of evidence in relation to a large number of other graphs of relativity which have been prepared over the years and summarised the effect of that evidence and the Tribunal’s reaction to it. The Tribunal found that the market was using a graph of relativity produced by the firm Gerald Eve (“the Gerald Eve graph”) and that the graph was the least unreliable. The main difference between the Gerald Eve graph and the Parthenia model is that the Gerald Eve graph is based on relativities derived from settlements reached on enfranchisement claims (between 1974 and 1996) whereas the Parthenia model derives relativity from sales in the market (between 1987 and 1991) using hedonic regression.

On appeal it was argued that the comparison between the value of the lease in the real world (with rights under the Act) and the value of the lease without such rights, as shown by the Parthenia model, was an illegitimate comparison. The two interests were fundamentally different. The legal effect of the assumptions that the Act requires precludes the valuer (and the Tribunal) from having regard to any leasehold transaction in the real world where the lease attracts rights under the Act. In other words, there is no direct relationship between the no-Act and subject-to-Act valuations, and, therefore, a comparison of the two is illegitimate as a matter of law. Further, the reason why the value of the lease in the real world is an impermissible comparator is that the market itself had been "corrupted" by the Gerald Eve graph. This argument was rejected. Among other things, the Court of Appeal said that whether to accept or reject the Parthenia model was a question of fact for the Tribunal, which could only be interfered with on appeal if the decision was perverse.

2.47 Figure 8 below sets out how marriage value might be valued for Houses 1 to 4 assuming the Gerald Eve graph is used to assess relativity. The detailed calculations are set out in Appendix 3.

<table>
<thead>
<tr>
<th>Figure 8: Calculation of the “marriage value” for Houses 1, 2, 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Houses 1, 3 and 4: The current leases have more than 80 years unexpired, so no marriage value is payable.</td>
</tr>
<tr>
<td>House 2: The current lease has less than 80 years unexpired so marriage value is payable. Marriage value payable by the leaseholder is £7,298 (being half of the marriage value).</td>
</tr>
</tbody>
</table>

The effect of high ground rents

2.48 We explained in paragraph 2.22 onwards above that high ground rents (including – but not limited to – onerous ground rents, such as those that double every 10 years) can make the calculation of the term very high.

2.49 In cases where marriage value is payable (because the lease has 80 years or less to run), onerous ground rents will also have a negative effect on the value of the existing lease and so will also increase the calculation of marriage value.57

2.50 If the lease for House 3 was 70 years rather than 241 years, the marriage value payable would be £8,471 (though the capitalised ground rent would be lower, since the duration of that income stream would be only 70 years).

The effect on enfranchisement premiums of high or onerous ground rents

There are three compounding factors that result in leaseholders with high or onerous ground rents being required to pay very high enfranchisement premiums:

(1) the ground rent that is being valued is already high, resulting in a high premium (see paragraph 2.22(1) above);

(2) it is then capitalised at a lower capitalisation rate, resulting in an even higher premium (see paragraph 2.22(2) above); and

(3) the ground rent de-values the existing lease, increasing the marriage value and resulting in a premium that is higher still (see paragraph 2.49 above).

Hope value

2.51 There is a value in the hope of being able to release marriage value in the future (“hope value”). Hope value is, in essence, a deferred form of marriage value. To return to the analogy of the Chinese vases we have used to explain marriage value at paragraphs 2.41 to 2.43 above the intrinsic value of each vase will be enhanced because of the hope of being able to do a deal with the other vase owner at some point in the future.

2.52 Applying to the context of a landlord and leaseholder, if the landlord is selling his or her freehold interest subject to a lease, but the leaseholder is not at that time interested in purchasing the freehold, there is “no immediate prospect of releasing the marriage value”.58 However, a potential purchaser of that freehold interest might well consider there to be a possible future benefit in selling the freehold to, or in acquiring the leasehold from, the leaseholder: the marriage value would be released at this later sale. This potential for a delayed release of marriage value is referred to as hope value. The

57 In Millard Investments Ltd v Cadogan (LON/LVT/1756/04), the Tribunal considered the correct approach to valuation of a ground rent that exceeded 0.1% of a property’s freehold value (which they considered to be “onerous”). The valuation that formed part of the decision included an additional step that capitalised the onerous portion of the ground rent and deducted the resulting capital sum from the value of the existing lease. This increased the marriage value and so also increased the premium payable by the leaseholder. Since then it has become common valuation practice to follow this approach whenever the ground rent exceeds 0.1% of the property’s freehold value, a level which is now generally considered to be onerous.

hope of being able to do a deal in the future is generally and logically less than an actual deal that is done now. Hope value is therefore less than marriage value.

2.53 As hope value is a deferred form of marriage value, it is impossible for both to be payable in relation to the same house or flat. However, in a collective enfranchisement claim, it is possible for marriage value to be payable in respect of some flats (the flats of the participating leaseholders) and hope value to be payable in respect of others (the flats of the non-participating leaseholders).

Summary

2.54 Figure 9 provides a summary of Houses 1-4, all three parts of the premium, and the total premiums payable.

Figure 9: enfranchisement premiums for Houses 1, 2, 3 and 4

<table>
<thead>
<tr>
<th>House</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Details of existing leases</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unexpired term</td>
<td>101 years</td>
<td>76 years</td>
<td>241 years</td>
<td>241 years</td>
</tr>
<tr>
<td>Ground rent</td>
<td>£50 pa - £250 pa</td>
<td>£50 pa - £200 pa</td>
<td>£300 pa, RPI increases</td>
<td>£300 pa - £9,600 pa</td>
</tr>
<tr>
<td>FHVP value</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£250,000</td>
<td>£250,000</td>
</tr>
<tr>
<td>Enfranchisement premiums</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part (1): term</td>
<td>£1,844</td>
<td>£1,806</td>
<td>£9,554</td>
<td>£79,422</td>
</tr>
<tr>
<td>Part (2): reversion</td>
<td>£2,303</td>
<td>£7,349</td>
<td>£3</td>
<td>£3</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
<td>£-</td>
<td>£7,298</td>
<td>£-</td>
<td>£-</td>
</tr>
<tr>
<td>Total premium</td>
<td>£4,147</td>
<td>£16,453</td>
<td>£9,557</td>
<td>£79,425</td>
</tr>
</tbody>
</table>

Collective freehold acquisition claims

2.55 Houses 1, 2, 3 and 4 are all freehold house purchases. The same principles apply to lease extensions of flats and collective enfranchisement claims of blocks of flats, where a premium is calculated in respect of each flat, and then aggregated. As explained in paragraph 2.53 above, marriage value is only payable in respect of the flats of participating leaseholders, while hope value is payable in respect of the flats of non-participants. Further, there may be added to the premium additional sums, for example, to reflect any development value in the building, which we now explain.

Development value, additional value and other loss

2.56 We have set out the three main components of an enfranchisement calculation: the term, the reversion and marriage value. The value of the reversion and/or any marriage value may include development value or other additional value, such as the ability to
release a restrictive covenant. Further, in some cases, landlords can demonstrate that the
enfranchisement claim causes them loss in respect of other property they own
("other loss"). For example, the acquisition of one terrace house may prevent a landlord
from developing the terrace as a whole. The legislation requires leaseholders to
compensate landlords for this other loss as well.

2.57 In the case of enfranchisement rights that are most commonly exercised by individual
leaseholders – namely acquiring the freehold of a house or a 90-year lease extension
of a flat – the requirement to pay the type of additional compensation set out in
paragraph 2.56 above is rarely encountered. An example of when a leaseholder may
be required to compensate a landlord in respect of other loss is when a landlord can
show that an individual lease extension claim will cause him or her to suffer loss in the
event of a future collective freehold acquisition claim in relation to the whole block.60

2.58 Most cases of additional compensation being payable to landlords concern collective
freehold acquisition claims. For example:

(1) There may be value to the landlord in being able to develop a block of flats, for
example, by building a further floor of flats on the roof. When the participating
leaseholders acquire the freehold to the block, they then have the ability to build
an extra floor of flats and realise that development value.

(2) There may be additional value which is referable to a particular flat, but which
can only be released on the expiry of the lease or through an earlier deal between
the leaseholder and the landlord. For example, if there is loft space owned by the
landlord above the top floor flat, the value of being able to incorporate it into the
flat could be realised on the expiry of the lease or through an earlier deal between
the leaseholder of the flat and the landlord.

2.59 Where there is additional value which is not dependent on a deal between parties (such
as example (1) above), it is relatively straightforward to compensate the landlord for the
loss of this value.

2.60 But additional value that can only be released by striking a deal (such as example (2)
above) is not so simple. The additional value can be characterised as a form of marriage
value, as the effect of doing a deal is the same as if the leaseholders’ and landlord’s
interests were in common ownership. Where there is only the hope of doing a deal, the
value is a form of hope value.

Potential alternative bases for assessing market value

2.61 We have set out above the most common method by which valuers and the Tribunal
assess the market value of the landlord’s interest. But as we explained in paragraph
2.11, the enfranchisement legislation does not require that method to be used. Broadly
speaking, all that the legislation requires is an assessment of the market value of the

59 Enfranchisement CP, paras 14.71 to 14.78.
60 See Nailrile Ltd v Cadogan [2009] EGLR 151, our discussion of the case in paras 16.99 to 16.101 of the
Consultation Paper, and our provisional proposal to address this problem in para 16.142 of the Consultation
Paper by suggesting that the rent in a headlease should be “commuted” on a lease extension claim.
landlord’s interest in the property. Alternative valuation methodologies could achieve that requirement. For example:

(1) if a recent local transaction involved an interest being acquired on the open market which is directly comparable to the asset that is the subject of an enfranchisement claim, then that transaction could, in theory, be used as a basis for assessing the market value of the landlord’s interest;

(2) in the case of very short leases (less than five years), valuers are directed by case law that:
   (a) the deferment rate should be the net rack rental yield\(^{61}\) that the evidence shows to be appropriate for the property in question; and
   (b) in addition there should be an end allowance to reflect the owner’s lack of control during the period of the reversion, which, in the absence of evidence establishing some other percentage, should be 5%.\(^{62}\)

2.62 More fundamentally, some consultees suggested to us that different valuation methodologies should be used in all cases in order to assess the market value of the landlord’s interest. They suggested that those methodologies should be used instead of the conventional approach that we have described above. We discuss these suggestions in Chapter 4 and explain why we have not pursued them.

(B): THE CURRENT VALUATION PROCESS

Introduction

2.63 Each enfranchisement claim is dealt with on its own merits. Usually, in all but low value claims, both the landlord and the leaseholder will appoint a valuer. Broadly speaking, the valuer for each party has three roles:

(1) Stage 1: to advise on what that party should expect to receive or pay in respect of the claim;

(2) Stage 2: to negotiate with the other valuer to seek to agree an enfranchisement premium; and

(3) Stage 3: if agreement cannot be reached, to provide expert evidence to the Tribunal about the appropriate premium.

2.64 Valuers are likely to produce different valuations for each of these three purposes.

Stage 1: valuations for advice

2.65 The valuer’s advice about the likely premium will be based on the valuer’s best assessment of the likely outcome of a negotiated settlement or a Tribunal ruling, or perhaps a range of potential likely outcomes. This valuation will not be shared with the

\(^{61}\) That is, a yield based on the annual rental value of the property after deducting management expenses.

other party, and the valuer is acting solely for his or her client, and will act in the client’s best interests.

Stage 2: valuations for negotiation

2.66 A valuation prepared for the purpose of negotiation with the other party is unlikely to produce the same premium. That is because the valuation is the “opening shot” in a negotiation. It will be shared with the other party as part of the negotiation process. It is likely to be based on figures which would produce the best possible outcome for the valuer’s client, yet which are within the range of figures that are credible or defensible in a negotiation process. The valuer is still acting solely for his or her client, and will act in the client’s best interests. The valuer’s fee agreement with his or her client can be based on an incentive structure so that the better the deal ultimately achieved from the valuer’s client’s point of view, the higher the valuer’s fees will be. For example, the fee for a valuer acting for a leaseholder may be based on a percentage of the difference between (a) the premium initially sought by the landlord, and (b) the premium ultimately agreed after negotiation by the valuers.

Valuing the term

2.67 To value the term, the landlord’s valuer will consider the rent review provisions in the lease, including the level of rent, the frequency of reviews and the way in which each review is calculated, and then apply a capitalisation rate. The leaseholder’s valuer will follow the same procedure and invariably produce a lower figure. The difference arises because each valuer is viewing the situation from the point of view of their own client, and endeavouring to reach a settlement that is in their own client’s best interests. For example, the valuer acting for the landlord will naturally argue for the application of a lower capitalisation rate, as this will produce a higher premium. Conversely, a valuer acting for a leaseholder will argue for a higher capitalisation rate to produce a lower premium.

Valuing the reversion

2.68 In a similar way, the present-day value of the landlord’s right to have the property back at the end of the lease is quantified by applying a deferment rate to the current freehold value of the property. The landlord’s and the leaseholder’s valuers will again have different opinions regarding both the value of the property and the appropriate deferment rate, and so this will again result in two different views about the value of the reversion. The landlord’s valuer will value the reversion as highly as possible by using a high FHVP value for the property and applying a low deferment rate, because that is in the best interests of the landlord. Conversely, the leaseholder’s valuer will value the reversion as low as possible by using a low FHVP value for the property and applying a high deferment rate, because that benefits the leaseholder.

Assessing marriage value

2.69 The leaseholder must pay to the landlord 50% of the total marriage value (where the lease has 80 years or less to run) and so, as in the case of capitalisation rates and deferment rates, the landlord’s and the leaseholders’ valuers will have contrary aims and will argue for what is in the best interests of their own client. The landlord’s valuer

---

63 See para 2.43 above.
will argue for a low relativity, which increases the share of marriage value payable by the leaseholder, while the leaseholder’s valuer will argue for a high relativity.

Extent of the disagreement between valuers

2.70 The difference between valuers’ views about the appropriate rates to adopt in a valuation can be significant.

(1) Capitalisation rates: until a few years ago, valuers commonly agreed a rate of between 5% and 7%. In a recent Tribunal decision, however, the landlord’s valuer argued that the appropriate capitalisation rate was 3.09%, whereas the leaseholders’ valuer argued that it should be 6%: the Tribunal determined in that case that the rate should be 3.35%.64

Many consultees gave us their views about what the appropriate capitalisation rate should be. The suggestions ranged from 3% to 10%.

(2) Deferment rates: following the decision in Sportelli, deferment rates are effectively prescribed on a nationwide basis at 4.75% for houses and 5% for flats, and currently most settlements are reached on that basis. However, consultees had a range of views about what the current true deferment rate should be, based on their assessment of the market, and their valuation approach. Suggestions ranged from 2.25% to 9.75% or higher.

(3) Relativity: in the decision in Mundy, the landlord’s valuer argued (in respect of one of the flats in that case) that relativity was 65.46% whereas the leaseholder’s valuer argued that it was 81.18%.

Worked examples

2.71 We have set out potential enfranchisement premiums for Houses 1, 2, 3 and 4 in Figure 9 above. But before those valuations were agreed between the valuers, or determined by the Tribunal, the valuers are likely to have prepared different valuations for the purposes of negotiation.

2.72 Figure 10 below shows what those different valuations might have been. The central column sets out the figures, rates and consequential enfranchisement premiums that might have been agreed by the parties or determined by the Tribunal. Those figures are taken from the worked examples above. The columns on either side set out the figures, rates and consequential enfranchisement premium that each parties’ valuer might have adopted at the outset of the negotiation process. We have used different rates based upon the range of rates that were suggested to us by consultees: see paragraph 2.70 above.

64 St Emmanuel House (Freehold) Ltd v Berkeley Seventy-Six Ltd CHI/21UC/OCE/2017/0025, 0026 and 0027.
Figure 10: different valuations that could have been prepared for Houses 1, 2, 3 and 4 for the purposes of negotiating the premium

<table>
<thead>
<tr>
<th>House 1</th>
<th>Initial valuation prepared by the leaseholder’s valuer</th>
<th>Agreed or determined valuation</th>
<th>Initial valuation prepared by the landlord’s valuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHVP value</td>
<td>£230,000</td>
<td>£250,000</td>
<td>£270,000</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>8%</td>
<td>6%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Deferment rate</td>
<td>6%</td>
<td>4.75%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Relativity</td>
<td>100%</td>
<td>98%</td>
<td>96%</td>
</tr>
</tbody>
</table>

Enfranchisement premiums

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>House 1</td>
<td>£1,301</td>
<td>£1,844</td>
<td>£2,620</td>
<td>£1,940</td>
</tr>
<tr>
<td></td>
<td>£639</td>
<td>£2,303</td>
<td>£8,364</td>
<td>£4,147</td>
</tr>
<tr>
<td></td>
<td>£-</td>
<td>£-</td>
<td>£-</td>
<td>£10,984</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 2</th>
<th>Initial valuation prepared by the leaseholder’s valuer</th>
<th>Agreed or determined valuation</th>
<th>Initial valuation prepared by the landlord’s valuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHVP value</td>
<td>£230,000</td>
<td>£250,000</td>
<td>£270,000</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>8%</td>
<td>6%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Deferment rate</td>
<td>6%</td>
<td>4.75%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Relativity</td>
<td>93%</td>
<td>90.5%</td>
<td>88%</td>
</tr>
</tbody>
</table>

Enfranchisement premiums

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>House 2</td>
<td>£1,293</td>
<td>£1,806</td>
<td>£2,489</td>
<td>£10,069</td>
</tr>
<tr>
<td></td>
<td>£2,745</td>
<td>£7,349</td>
<td>£19,765</td>
<td>£16,453</td>
</tr>
<tr>
<td></td>
<td>£6,031</td>
<td>£7,298</td>
<td>£5,073</td>
<td>£27,327</td>
</tr>
<tr>
<td>House 3</td>
<td>Initial valuation prepared by the leaseholder’s valuer</td>
<td>Agreed or determined valuation</td>
<td>Initial valuation prepared by the landlord’s valuer</td>
<td></td>
</tr>
<tr>
<td>---------</td>
<td>------------------------------------------------------</td>
<td>--------------------------------</td>
<td>-----------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Figures and rates adopted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FHVP value</td>
<td>£230,000</td>
<td>£250,000</td>
<td>£270,000</td>
<td></td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>8%</td>
<td>4%</td>
<td>2.5%</td>
<td></td>
</tr>
<tr>
<td>Deferment rate</td>
<td>6%</td>
<td>4.75%</td>
<td>3.5%</td>
<td></td>
</tr>
<tr>
<td>Relativity</td>
<td>100%</td>
<td>99%</td>
<td>98%</td>
<td></td>
</tr>
<tr>
<td>Enfranchisement premiums</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part (1): term</td>
<td>£4,739</td>
<td>£9,554</td>
<td>£15,296</td>
<td></td>
</tr>
<tr>
<td>Part (2): reversion</td>
<td>£-</td>
<td>£3</td>
<td>£68</td>
<td></td>
</tr>
<tr>
<td>Part (3): marriage value</td>
<td>£-</td>
<td>£-</td>
<td>£-</td>
<td></td>
</tr>
<tr>
<td>Total premium</td>
<td>£4,739</td>
<td>£9,557</td>
<td>£15,364</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 4</th>
<th>Initial valuation prepared by the leaseholder’s valuer</th>
<th>Agreed or determined valuation</th>
<th>Initial valuation prepared by the landlord’s valuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figures and rates adopted</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FHVP value basis</td>
<td>£230,000</td>
<td>£250,000</td>
<td>£270,000</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>8%</td>
<td>4%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Deferment rate</td>
<td>6%</td>
<td>4.75%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Relativity</td>
<td>100%</td>
<td>99%</td>
<td>98%</td>
</tr>
<tr>
<td>Enfranchisement premiums</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part (1): term</td>
<td>£18,736</td>
<td>£79,422</td>
<td>£183,991</td>
</tr>
<tr>
<td>Part (2): reversion</td>
<td>£-</td>
<td>£3</td>
<td>£68</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
<td>£-</td>
<td>£-</td>
<td>£-</td>
</tr>
<tr>
<td>Total premium</td>
<td>£18,736</td>
<td>£79,425</td>
<td>£184,059</td>
</tr>
</tbody>
</table>

2.73 As we explain further in Chapter 4 below, we are not a body of expert valuers and it is not for us to say what the appropriate rates are. The examples above are therefore indicative only: different figures and rates will be used by different valuers. But the examples demonstrate how significantly different the parties’ valuations – prepared for the purpose of negotiations – can be. In turn, leaseholders will often be daunted by how
high the enfranchisement premium might end up being, and will be uncertain about the likely outcome of their claim.

Stage 3: valuations for Tribunal determination

2.74 Despite the contrary aims of the two valuers, negotiated settlements are usually reached for most enfranchisement claims. But if agreement cannot be reached, then the premium will be determined by the Tribunal.

2.75 Each valuer will prepare a valuation for consideration by the Tribunal. That valuation is likely to be different from the previous valuations prepared by the valuer. The valuer is giving his or her expert opinion to the Tribunal as to what the enfranchisement premium should be. When giving expert evidence, the valuer is required by the Tribunal rules to act independently, rather than in the interests of his or her client. Accordingly, the valuation ought to be a balanced objective and independent assessment of the appropriate premium. In theory, the valuer would produce the same valuation whether his or her client is the leaseholder or the landlord. But this expectation is unrealistic because, as we explained previously, there are no "correct" rates for capitalisation, deferment and relativity, only ranges of what might be applicable. Each valuer will tend to consider the ends of the ranges that favour his or her own client to be correct (otherwise agreement would already have been reached) and so although a difference of opinion between the valuers may be reduced, it will still exist.

2.76 When giving expert evidence, incentive-based fees are not permitted, so the valuer's fee cannot vary depending on the outcome of the Tribunal hearing. Rather, the valuer will usually charge an hourly rate for the work involved in the preparation for, and attendance at, a Tribunal hearing.

CONCLUSION

2.77 We have set out how enfranchisement premiums are calculated in principle and in practice. The next chapter explains the criticisms that have been made of the current regime.

---

65 The Tribunal Procedure (First-tier Tribunal) (Property Chamber) Rules 2013, r 19(1).
Chapter 3: Arguments about reform

INTRODUCTION

3.1 During our consultation, and throughout the course of our project, we have heard:

(1) criticisms of the existence of any requirement to pay enfranchisement premiums;

(2) criticisms of the basis on which those premiums are calculated and the process that must be followed; and

(3) technical criticisms about the assessment of enfranchisement premiums.

3.2 We have also heard criticisms of one of the objectives for our project, set out in our Terms of Reference, namely to reduce premiums for leaseholders.

3.3 In this chapter, we summarise the various criticisms that have been made under three headings.

(1) First, we explain the argument that leasehold ownership is inherently unfair, which permeates many of the arguments – particularly those made by leaseholders – about why premiums should not be payable in order to enfranchise, or should be reduced or otherwise reformed.

(2) Second, we discuss and comment on some of the problems to which the current regime gives rise. Some of those problems are very practical and are felt by both leaseholders and landlords at the coalface as they are navigating the enfranchisement process. Others are very technical or difficult to understand by anyone other than a specialist lawyer or valuer. These are all problems with the law which, in our view, any reform should seek to address.

(3) Third, we set out the arguments for and against reducing premiums that have been raised with us. We deliberately do not express a view on whether or not it is right to seek to reduce premiums, since that is a mixed question of law, valuation, social policy and – ultimately – political judgement. In our project, we have worked within Terms of Reference which ask us to examine the options to reduce premiums. Nevertheless, we set out the arguments for and against reducing premiums since consultees have commented on the issue, and since the objective of reform is crucial when it comes to assessing the compatibility with A1P1 of options for reform that would reduce premiums.

(1) OPPOSING VIEWS ON WHETHER LEASEHOLD OWNERSHIP IS INHERENTLY UNFAIR

3.4 A very firmly held view among a great many leaseholders is that leasehold ownership is inherently unfair to leaseholders. That perceived underlying unfairness then exhibits itself when enfranchisement premiums are discussed. The view has been expressed to us at consultation events, in consultation responses, and in correspondence, and we
are aware that similar views have been expressed to Government, Parliamentarians and other organisations.

<table>
<thead>
<tr>
<th>How representative of all leaseholders are the views that we have heard?</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have heard from or spoken to thousands of leaseholders during the course of our project, and over 1,500 leaseholders responded to our online survey to tell us about their experiences of the enfranchisement process. Similarly, Government's consultations about leasehold reform have resulted in many thousands of responses from leaseholders complaining about leasehold.</td>
</tr>
<tr>
<td>We acknowledge that these leaseholders make up only a fraction of leaseholders – of whom there are at least 4.2 million in England, plus many in Wales (but about whom there are no data). Some landlords have suggested that the strong views that we have heard from leaseholders are not representative of all leaseholders, and that reform should not be based on the unrepresentative view of an aggrieved minority. We do not agree with that view. Although we do not have data that gather the views and experience of all of the millions of leaseholders in England and Wales in a representative way, there are various indications that dissatisfaction with leasehold is widespread. For example:</td>
</tr>
<tr>
<td>- an opinion poll conducted by NAEA Propertymark found that 94% of leaseholders regretted buying a leasehold property.66</td>
</tr>
<tr>
<td>- an online petition to “abolish leasehold” gathered over 30,000 signatures.67</td>
</tr>
<tr>
<td>- complaints about leasehold have been raised with numerous Members of Parliament, and 177 Parliamentarians indicated their concern about leasehold by joining an All-Party Parliamentary Group (“APPG”) on Leasehold and Commonhold Reform.68 The APPG is one of the largest in Parliament.</td>
</tr>
<tr>
<td>- the Conveyancing Association’s research, which led to its White Paper on home moving, raised various problems with leasehold, in particular that it can cause additional unnecessary delay and expense in the conveyancing process.69</td>
</tr>
</tbody>
</table>

3.5 Leaseholders who are bringing an enfranchisement claim are doing so as a result of having previously acquired an interest which is diminishing in value over time. When they bought their lease, many leaseholders will have paid a premium that was not substantially different (or not at all different) from the value of a freehold interest in the property. They would say that they had no choice but to acquire a leasehold interest, and consider that they are being asked to pay again for the home they have already bought. And many leaseholders will not have been aware of, or will not have understood, the diminishing value of their interest, or that the cost of extending their lease or acquiring the freehold would increase substantially over time.

---

67 See https://petition.parliament.uk/petitions/238071.
68 There were 177 members of the APPG when Parliament was dissolved before the 2019 general election.
3.6 We have also been told that many prospective purchasers of houses and flats – particularly first-time buyers – do not have a full understanding of the terms of the lease or of the implications of owning a leasehold property. In some cases, buyers of leasehold houses may not even realise when purchasing a leasehold house that they will not become its outright owner. As one stakeholder said to us, people have set their heart on a home and are measuring for curtains and furniture before the lease is explained to them. We discussed the exploitation of consumers’ “behavioural biases” in our project on Event Fees. Consumers fail to give adequate weight to future costs in assessing the quality of an offer as a whole. This analysis may also explain consumers’ willingness to purchase long leases (perhaps at a similar price to a freehold interest) despite the further sums that will have to be paid in the future.

3.7 Leaseholders often find themselves compelled to make an enfranchisement claim, either (i) because they wish to sell their lease and a purchaser can only be found (or will only be able to obtain a mortgage) if the length of the lease is increased, or (ii) because they know that the cost of doing so in the future will likely be higher than it is at present. They are compelled to make a claim in order to be able to protect the value of their interest from reducing further. And in the majority of cases, that interest is not only an asset but also their home.

3.8 The mere fact that leaseholders have to engage with the enfranchisement process at all – no matter how simple, quick and cheap it is – can, therefore, be a cause of frustration and anger. And once they do engage with the process, they realise that they also have to pay their landlord a premium, plus the landlord’s legal costs, and their own legal costs – for a process that, in their view, should not be necessary in the first place. The aspirations of “home ownership” are undermined as leaseholders realise that they face the prospect of making a claim which will take emotional energy, will be lengthy and complicated, and will cost a large amount of money. Leaseholders will therefore often feel that they are being treated unfairly.

3.9 By contrast, landlords would argue that they only ever granted – and were only ever paid for – a time-limited interest. Those who purchased such an interest would have known, or ought to have known, that its expiry in the future would entail a process, and a sum of money being paid, in order to extend the interest. Landlords would argue that they are entitled to the assets that they own. To some, the very existence of a compulsory purchase regime that entitles leaseholders to force landlords to hand over their asset is objectionable. To others, such a power of compulsory purchase must be

---


accompanied by an obligation to pay full compensation for the deprivation of the landlord’s interest.

3.10 So, to landlords, any feeling of unfairness amongst leaseholders is caused by a lack of consumer awareness about the nature of leasehold ownership, or by inadequate advice from their lawyers, rather than by a systemic failure of the leasehold regime. Landlords argue that they are merely seeking to protect their legitimate property interests. But for leaseholders, no amount of consumer awareness of the true position will overcome the fundamental feeling of unfairness of the leasehold system, and its inability to deliver the benefits they expect to achieve through owning their home.

3.11 These competing views are genuinely held and irreconcilable. Decisions about which side to favour, and how to strike the balance between the competing interests, depend to a large extent on political judgement.

(2) PROBLEMS WITH THE LAW GOVERNING THE CALCULATION OF PREMIUMS

Problems with the current law

Complexity

3.12 The valuation process is complex:

(1) there are various different valuation formulae for the purchase of a house, and which of them is applicable depends on historic rateable values; and

(2) the valuation methodology and process (summarised in Chapter 2) for houses and flats are not readily understandable to the lay person. Many lawyers struggle to understand the methodology and many professional valuers struggle with the more complex cases.

“Many practitioners are not aware of the process and options... it took 6 months to find a law practitioner who is actually knowledgeable and reasonable”. (A leaseholder responding to our survey)

“Current methodology undoubtedly makes claims much more expensive, complex, costly and worrying for both parties, unless they are very practised in these ‘arts’”. (Jennifer Ellis, a surveyor)

“The current methodology is so complex that it must scare off most leaseholders. Very few professionals understand the different bases for valuation of a freehold in an enfranchisement claim in respect of a low value house: what chance does a layman have”? (Tapestart Limited, a commercial investor)

Unpredictable outcomes

3.13 Valuation is not an exact science. As we discussed in Chapter 2, valuers can have very different views on the way in which an enfranchisement premium should be valued. So there is a significantly wide valuation margin and a lack of standardisation. Different experts will form different views as to the appropriate inputs into the valuation and indeed the various inputs will vary between locations, properties and over time. This in turn gives ample scope for disputes, both during negotiations and before the Tribunal, and thereby increases costs, delay and uncertainty as to the ultimate price the leaseholder will have to pay.
The methodology was misused by both sets of surveyors to reach wildly different amounts in my claim. This slowed down the whole process while they negotiated - why did they need to negotiate? The value should have been fixed using one method… This delay cost me thousands more in legal fees.” (Catherine Williams, leaseholder)

Room for argument

There is ample room to argue about what the various inputs into a valuation calculation should be. Different valuers will take different views when giving advice, during negotiations, or when giving evidence at the Tribunal. The parties, or their valuers, will therefore argue about, and litigate over, what the inputs should be. For example, disputes can arise in respect of the following.

- FHVP values (see paragraph 2.32 above);
- capitalisation rates (see paragraph 2.19 onwards above);
- deferment rates (see paragraph 2.34 onwards above);
- relativity (see paragraph 2.44 onwards above);
- discount for leaseholder’s improvements (see paragraph 6.223 onwards below);
- discount for the risk of holding over (see paragraph 6.250 onwards below);
- development value (see paragraphs 2.56 above and 6.155 below); and
- other appropriate assumptions.72

Inconsistency and irrationality in the regime

3.14 There are numerous inconsistencies in the enfranchisement regime as a whole, which we discussed in the Consultation Paper. In terms of valuation, the main inconsistency is between the treatment of (1) houses that satisfy particular criteria for which the “original valuation basis” applies, and (2) other houses, and all flats, for which the “mainstream valuation basis” applies.

3.15 Leaseholders in the former category enjoy a more favourable basis of valuation, but the criteria which must be satisfied in order to fall within that category are unsatisfactory and irrational. First, it can be difficult in practice to ascertain whether a particular property meets the relevant criteria, since it depends on historic values of properties which sometimes cannot be traced – or can only be traced at great expense. Second, the way in which those historic financial limits operate in the present day can be irrational: there are houses which were low value historically but which are now very valuable, yet they enjoy the original valuation basis; by contrast, there are houses which are currently worth far less, but which do not quite fall within the relevant financial limits, so the leaseholder must pay a premium based on the mainstream valuation basis. We

---

72 See for example the case of Money v Cadogan Holdings [2013] UKUT 0211 (LC) discussed in para 14.75 of the Consultation Paper.
give some examples of cases in which the different valuation regimes apply in Figure 11.

**Figure 11: some examples of the operation today of financial limits dating back to 1967**

A mews house in London with a freehold vacant possession value of £2,528,750 fell within the financial limits and qualified for a valuation under the original valuation basis.

A flat above a shop (outside London) which we have been told about, with a freehold vacant possession value of £275,000, fell above the financial limits and therefore fell to be valued under the mainstream valuation basis.

A 3-bedroom semi-detached house in Sutton Coldfield, with a freehold vacant possession value of £285,000, fell above the financial limits and the enfranchisement premium was valued under the mainstream valuation basis.

3.16 Whether a property falls within the original or the mainstream valuation basis can make a significant difference to the premium: see Figure 12.

**Figure 12: difference between premiums under the original valuation basis and under the mainstream valuation basis**

In the case of the mews house in Figure 11 above, which was valued under the original valuation basis, the premium was £45,000. Had the enfranchisement premium been valued on the mainstream valuation basis, the premium would have been in the region of £275,000.

In the case of the flat above a shop in Figure 11 above, which was valued on the mainstream valuation basis, the premium was around £82,000. Had the enfranchisement premium been valued under the original valuation basis, the premium would have been in the region of £20,000.

In the case of a property in Wales which we have been told about, with a freehold vacant possession value of £55,000, and which was valued under the original valuation basis, the premium was around £16,500. Had the enfranchisement premium been valued on the mainstream valuation basis, the premium would have been in the region of £46,000.

**Artificiality**

3.17 The price payable is to be ascertained by reference to the market value of the interest being acquired, but subject to various statutory assumptions. Most notably of these is the assumption that there are no enfranchisement rights attached to the interest – that is to say, that the leaseholder of a property has no right to buy the freehold of that property or claim a lease extension of it. In reality, nearly all leasehold properties benefit from statutory enfranchisement rights and therefore “the market value” is, to a certain extent, artificial. This leads to two problems: (1) how to value an interest on a hypothetical sale in the market; and (2) circularity.

“As most of the comparable evidence ... [is] derived from transactions in a market where the effects of the legislation are prevalent and ubiquitous, it is difficult to determine and isolate the effect of the legislation to adjust sales evidence to derive an accurate "no Act world" value, as required by the legislation. Both practitioners and tribunals continue to struggle with this impossible task.” (Cerian Jones, surveyor)
Artificiality: hypothetical valuation

3.18 We referred to the decision in Mundy above. The leaseholders’ valuer argued that relativity should be calculated using the Parthenia model, which was based on sales of properties between 1987 and 1991, that is, before the distortion of the market caused by the 1993 Act and by the prospect of the 1993 Act. The landlords’ financial experts, who the Tribunal thought were probably right, rejected the application of the Parthenia model because they considered that there had been substantial changes in the market and the economic environment since 1991, so historic data lacked relevance when calculating current values.

3.19 If historic real-world sales are no longer relevant and all recent sales are tainted by the enfranchisement legislation, then it is hard to see how the value of an existing lease without enfranchisement rights can ever be ascertained with certainty. While the valuation is said to be directed at ascertaining market value, it is attempting to value something which no longer exists to be valued.

Artificiality: circularity

3.20 Buyers of leasehold property in the real world are buying on the basis that the enfranchisement legislation confers the right to buy the freehold of such property (or to extend the lease of it). Consequently, in deciding what to pay for a relatively short lease of a property, buyers in the market will have regard to what they are likely to have to pay in order to acquire the freehold interest of the property (or to extend that lease), through exercising enfranchisement rights. The value of the relatively short lease will be the cost of exercising the enfranchisement rights subtracted from the freehold value of the property (or the value of an extended lease of the property): see Figure 13 below.

3.21 In turn, however, the cost of exercising the enfranchisement rights in respect of the relatively short lease will be determined by the price that similar short leases are selling for in the market. The premium for the exercise of enfranchisement rights will be the value of similar short leases in the market subtracted from the freehold value of the property (or subtracted from the value of an extended lease of the property).

3.22 In other words:

(1) the market value determines the price payable under the enfranchisement legislation; and

(2) the price payable under the enfranchisement legislation determines the market value.

There is a strong element of circularity.

---

73 Para 2.45 and Fig 7.

74 In this context, by short lease we mean a lease which is of such a length that the buyer would look to extend it or acquire the freehold of the property during his or her period of ownership.
3.23 This circularity is arguably compounded by Tribunal decisions. In *Mundy* the Tribunal said that valuers are to focus on actual market forces at the valuation date. In other words, they are to take account of factors which were influencing the market at that date – for example, a particular case or graph of relativity – and ignore the fact that the market was badly informed or operating illogically or inappropriately. The Tribunal found that the market was using the Gerald Eve graph and that the graph was the least unreliable. The premiums assessed by tribunals in future cases will now follow the Tribunal’s decision and that, in turn, produces the result that in the market, when a purchaser of an existing lease with rights under the enfranchisement legislation is advised on the amount of the estimated premium for a lease extension, he or she will be advised on the basis of the Gerald Eve graph.

3.24 In other words:

(1) the Tribunal bases its decisions on the behaviour of the market; and

(2) the market bases its behaviour on the decisions of the Tribunal.

3.25 The problem can be further exemplified by considering the decision in *Mundy* relative to the decision in *Kosta v Carnwath*. Mr Kosta, the leaseholder, attempted to rely on the Parthenia model. The landlord’s valuer thought reliance on an average of the available graphs of relativity would be more palatable than reliance purely on the Gerald Eve graph. Consequently, he adopted an average relativity in circumstances where that

---

relativity coincided with the relativity derived from the Gerald Eve graph. The Tribunal in *Mundy* said of *Kosta*:

In *Kosta* the Tribunal held that a prospective purchaser of an existing leasehold interest, acting prudently, would have taken an average of the relevant graphs contained in the RICS 2009 report when assessing relativity. We have had the benefit of hearing detailed evidence about the construction and use of those graphs. From such evidence we are satisfied that at the valuation dates a prospective purchaser would not have taken an average relativity from those graphs. It is most likely that they would have referred to the [Gerald Eve] graph first and foremost. The evidence was that the market had only started to adopt an average relativity from the graphs following the decision in *Kosta*.

3.26 In other words, as a matter of legal precedent, the approach in *Kosta* cannot be relied upon following the decision in *Mundy*. However, where the valuation date falls after the decision in *Kosta*, but before the decision in *Mundy*, applying the guidance in *Mundy* that one must look at factors which influenced the market at the valuation date, the decision in *Kosta* can be taken into account.

Other technical problems

3.27 There are a number of technical criticisms of the valuation provisions in the 1967 Act and the 1993 Act, which we referred to throughout Chapters 14 and 15 of the Consultation Paper. We also listed some technical problems with the original valuation basis in paragraph 14.106 of the Consultation Paper.

Practical consequences of those problems

3.28 We have described various problems with the current law. Those problems – particularly the complexity and unpredictability of the regime – result in some very practical difficulties for leaseholders and landlords who engage with the enfranchisement process, which we now explain.

Uncertainty

3.29 The valuation methodology (set out in Part 1 of Chapter 2) is relatively clear. But in practice the outcome of any given enfranchisement claim can be far from certain. That is because there is considerable uncertainty about how the valuation methodology will operate in any given case (the process is set out in Part 2 of Chapter 2). Valuation is not an exact science. It involves a number of known and unknown variable factors. It depends on the particular features of the lease and the property, it depends on the appropriate rates, and so on: see Chapter 2.

3.30 The result is that, from the outset of the claim all the way through to the agreement or determination of the claim, leaseholders and landlords do not know what the premium will be: see Figure 14 below.

<table>
<thead>
<tr>
<th>Figure 14: uncertainty about enfranchisement premiums for Houses 1, 2, 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Figure 10 above, we set out the valuations that the parties' valuers might have prepared for the purposes of negotiation. The leaseholder and landlord will not know what figure, between those two extremes, the premium is going to be, until the claim is concluded (by agreement or</td>
</tr>
</tbody>
</table>
by Tribunal determination). Taking those figures, the leaseholder and landlord will not know what figure the premium is going to be:

- (for House 1) between £1,940 and £10,984;
- (for House 2) between £10,069 and £27,327;
- (for House 3) between £4,739 and £15,364;
- (for House 4) between £18,736 and £184,059.

3.31 The outcome of an enfranchisement claim does not just depend on differences of opinion about valuation. It can also depend on, and therefore the uncertainty of outcome can be influenced by, for example:

1. the advice, negotiation skills, and expert evidence of one party’s valuer;
2. the quality of the particular valuer’s evidence (as assessed by the Tribunal);
3. the parties’ negotiating position – for example, a leaseholder who is eager to sell their property, but who needs to enfranchise before doing so, may be more inclined to pay a higher premium in order to finalise the transaction;
4. the parties’ risk appetite – for example, whether the parties want to run the risk, and incur the cost, of a Tribunal hearing; and
5. whether the landlord has other leaseholders in a similar position and so is concerned that the premium agreed for one property will be seen as setting a precedent for others.

3.32 The parties can estimate the likely outcome and their valuers can provide advice on the likely outcome, but valuers cannot predict the future and so ultimately there is no certainty at all until the end of the claim. The parties must therefore live with uncertainty – including significant financial uncertainty – for a long time. The leaseholders might also be daunted by the prospect of an enfranchisement claim which could result in a very high premium.

1. To take the figures for House 1 (in Figure 10 above), the leaseholder’s valuer prepares an initial valuation for negotiation purposes of £1,940, and might have provided initial advice to the leaseholder estimating that the ultimate premium is likely to be around £4,150. But the leaseholder then receives the landlord’s valuer’s proposed premium of £11,000.

2. For Houses 2, 3 and 4, the different potential valuations are even more stark.

3. To provide a recent example, in a relatively recent Welsh Leasehold Valuation Tribunal decision, the leaseholder’s valuer argued for a premium of £300,
whereas the landlord's valuer contended that the correct figure was £10,000. The Tribunal determined a premium of £185.76.

3.33 For an ordinary leaseholder, the potential sums involved can be daunting, or, indeed, beyond their reach.

“A Lease Valuation Expert provided estimates for the cost of lease extension in May 2017. With a remaining sub-lease of 97.56 years, a ground rent of £450 which doubles every 25 years, and assuming a wholly positive profit rent situation, the estimate to extend the sub-lease of our flat was £15,600. The second estimate of £59,100 assumed a wholly negative profit rent situation”. (A leaseholder responding to our survey)

“I looked into enfranchisement but I was quoted that it could cost between 15K and 60K to buy my share of the freehold and no one could say exactly how much until we had spent the money on the surveyors to get a ballpark, and this wouldn’t even give us legal costs (landlady's and ours)”. (A leaseholder responding to our survey)

“Have no idea what the premium is going to be and whether such figure would be reasonable. This has prevented exercising enfranchisement rights.” (Graham Foster, leaseholder)

3.34 Different people have different tolerances to uncertainty. A large organisation is better able to plan for and cope with uncertainty than an individual. For individuals, particularly leaseholders who own their own homes, the uncertainty will often bring with it emotional stress, exhaustion and frustration.

The stakes are high

3.35 Much can turn on which valuer’s view prevails during negotiations. A difference of just 1% in the capitalisation rate, deferment rate and relativity can have a significant effect on premiums: see Figure 15.

3.36 The parties can therefore find themselves in an invidious position. Do they stick to their valuation and run the risk of an unfavourable decision by the Tribunal? Can they afford to pay their lawyer and valuer to attend the Tribunal hearing (and those costs are irrecoverable, regardless of the outcome of the decision)? The parties must decide whether to take a gamble, or whether a bird in the hand is worth two in the bush. And for the leaseholder that decision must often be made (as we explain in paragraph 3.45 below) against the background of an inequality of arms.

### Figure 15: effect on enfranchisement premiums of a 1% change in the various rates

<table>
<thead>
<tr>
<th>House 1</th>
<th>Rate</th>
<th>1% change in rates in favour of leaseholder</th>
<th>As per Figure 9 above</th>
<th>1% change in rates in favour of landlord</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Capitalisation rate</td>
<td>7%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Deferment rate</td>
<td>5.75%</td>
<td>4.75%</td>
<td>3.75%</td>
</tr>
<tr>
<td></td>
<td>Relativity</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

#### Effect of changing rates on enfranchisement premium

| Part (1): term | £1,528 | £1,844 | £2,305 |
| Part (2): reversion | £882 | £2,303 | £6,069 |
| Part (3): marriage value | £- | £- | £- |
| **Total premium** | **£2,410** | **£4,147** | **£8,374** |

<table>
<thead>
<tr>
<th>House 2</th>
<th>Rate</th>
<th>1% change in rates in favour of leaseholder</th>
<th>As per Figure 9 above</th>
<th>1% change in rates in favour of landlord</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Capitalisation rate</td>
<td>7%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Deferment rate</td>
<td>5.75%</td>
<td>4.75%</td>
<td>3.75%</td>
</tr>
<tr>
<td></td>
<td>Relativity</td>
<td>91.5%</td>
<td>90.5%</td>
<td>89.5%</td>
</tr>
</tbody>
</table>

#### Effect of changing rates on enfranchisement premium

<p>| Part (1): term | £1,511 | £1,806 | £2,219 |
| Part (2): reversion | £3,570 | £7,349 | £15,235 |
| Part (3): marriage value | £8,085 | £7,298 | £4,398 |
| <strong>Total premium</strong> | <strong>£13,166</strong> | <strong>£16,453</strong> | <strong>£21,852</strong> |</p>
<table>
<thead>
<tr>
<th>House 3</th>
<th>Rate</th>
<th>1% change in rates in favour of leaseholder</th>
<th>As per Figure 9 above</th>
<th>1% change in rates in favour of landlord</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalisation rate</td>
<td>5%</td>
<td>4%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Deferment rate</td>
<td>5.75%</td>
<td>4.75%</td>
<td>3.75%</td>
<td></td>
</tr>
<tr>
<td>Relativity</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Effect of changing rates on enfranchisement premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part (1): term</td>
</tr>
<tr>
<td>Part (2): reversion</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
</tr>
<tr>
<td>Total premium</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 4</th>
<th>Rate</th>
<th>1% change in rates in favour of leaseholder</th>
<th>As per Figure 9 above</th>
<th>1% change in rates in favour of landlord</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalisation rate</td>
<td>5%</td>
<td>4%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Deferment rate</td>
<td>5.75%</td>
<td>4.75%</td>
<td>3.75%</td>
<td></td>
</tr>
<tr>
<td>Relativity</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Effect of changing rates on enfranchisement premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part (1): term</td>
</tr>
<tr>
<td>Part (2): reversion</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
</tr>
<tr>
<td>Total premium</td>
</tr>
</tbody>
</table>

**Expensive procedure**

3.37 The complexity of valuation means that it is very difficult to enfranchise without some professional assistance, and expensive specialist expertise will often be necessary. In turn, the scope for disagreement between valuers gives rise to even higher valuation costs.
“Firstly the leaseholder has to pay for 2 surveyors and 2 solicitors to even get a price of the leasehold extension. After spending £4-5,000 on the surveyors and solicitors the leaseholder may well not be able to afford the lease extension so will have wasted time and a lot of money … . The calculation is too complicated which is why the leaseholder needs to pay for 2 surveyors and 2 solicitors”. (Jeanette Allen, a leaseholder)

3.38 The legal and valuation costs will increase when (for example) the enfranchisement claim takes longer, or when it raises complicated issues, or where the parties disagree on many issues. The costs will increase even further when agreement cannot be reached and the claim has to be decided by the Tribunal.

3.39 But even in relatively straightforward claims, the professional costs can be significant. Where the capital value of the property is low, the professional fees may be disproportionate to the price payable. In some cases, the costs involved actually exceed the premium payable.

3.40 The professional costs are borne by both leaseholders and landlords, though leaseholders are currently required to pay towards their landlords’ costs so will often feel the burden of costs more acutely.77

Delays

3.41 The scope for argument about valuation can delay the enfranchisement process. That is because there can be a lengthy period of negotiation between valuers followed, in some cases, by lengthy proceedings before the Tribunal. Those delays cause problems for both landlords and leaseholders. For example, a leaseholder may need to extend his or her lease before it can be sold; a lengthy enfranchisement process can therefore result in a delay to the leaseholder moving home.

Potentially arbitrary outcomes

3.42 The current valuation regime results in a tailored premium for each particular enfranchisement claim. The purpose of that tailored premium is to try to ensure that the premium reflects, as far as possible, the market value of the landlord’s property interest which is being acquired by the leaseholder.

3.43 But in reality, the premiums that are agreed can be arbitrary. As a result of the uncertainty about the figures to use in the premium calculation, the premium can depend on the identity of the valuer that each party has selected. Some valuers might be particularly good negotiators; some might give particularly compelling evidence at the Tribunal; some who deal with enfranchisement on a daily basis might have a better understanding of the valuation provisions than others; some might make mistakes, or make unwise concessions during negotiations.

“My problem was with my choice of surveyor. His report recommended a fair price for the premium to be between £58,000 to £68,000 with an opening figure of £42,000 and the landlord’s counter notice was for £69,000. After we served the notice I discovered that my immediate neighbours who had exactly the same lease and landlord as me had settled a premium of £51,000 in January 2018, just before I started the process. At the time my notice was served my

77 We will discuss the current requirement for leaseholders to pay towards their landlords’ costs in our second report.
lease was ten months shorter than theirs, but I was hopeful that I would pay the same as them as they had a larger maisonette due to a loft extension. However, four months into the process my surveyor informed me that he had managed to negotiate down to £61,000 and tried to insist I settle at that. I told him about my neighbours and asked him to negotiate further. The landlord claimed that a similar flat had sold in my road for £705,000, that my lease was ten months shorter than my neighbours had been at the time of application and that the Appeal court’s ruling in January 2018 in the Sloane Stanley versus Mundy had favoured the way landlords calculate premiums. I discovered that the £705,000 flat had a share of the freehold and a double width garden so was not comparable. My surveyor again tried to insist I accept £61,000 but I refused.

As the deadline for applications to Tribunal approached I heard nothing new from my surveyor so I went ahead with the application in October and requested 3 month’s abeyance. Within a week my surveyor informed me that the landlord had agreed a figure of £55,500 which I reluctantly accepted.

My neighbour’s surveyor’s report included his calculations and yet my surveyor told me I had to trust him when I asked to see his. In March 2017 one surveyor calculates £45,000 to be a fair price to pay and nearly one year later another calculates it to be £61,000. The market value of these flats has not increased in the last two years. In hind sight I wish I had asked my neighbours for their surveyor who would have been through negotiations with the landlord but I assumed all surveyors worked on the same principles and would have arrived at similar figures in their calculations”.

(A leaseholder responding to our survey)

Undesirable incentive structures

3.44 Various aspects of the enfranchisement regime create undesirable incentive structures. The regime can encourage an unhelpful tactical “gaming” approach to negotiations, which tends to favour more experienced landlords over leaseholders. The complexity of the regime gives plenty of scope for parties to disagree, or to argue different positions. The threat of litigation about those points, and the time it can take to resolve disputes, can be used tactically against a party who is seeking to complete the process speedily and at minimal cost.

“I encountered many difficulties which I would summarise as landlords taking advantage [of the] system to attempt to rip me off which I avoided by representing myself:

1) Initial counter offer of £5,000 more since they know [it will cost most] leaseholders at least that to oppose.

2) Charging for VAT when they are not VAT eligible, since most leaseholders don’t demand the evidence.

3) Initially overcharging for their legal costs by £2K since they know it will cost you that to contest.

4) Since I pay for their legal costs there is no incentive to mitigate their costs. …”

(A leaseholder responding to our survey)

“Landlords often ask for excessive premiums and use the [Tribunal] to their advantage as leaseholders pick up the majority of the costs.” (Karl Layland, leaseholder).

“A lease extension or enfranchisement is a distressed purchase with a lay leaseholder with a low bargain position at one end and a sophisticated professional freeholder blocking the way to
a sale or remortgage until the deal is done. The costs and delays have got out of control and
history shows that this is cyclical and requires Government control to bring the bargaining
positions back into balance." (Beth Rudolf, Rupert Houltby and the Conveyancing Association)

Inequality of arms

3.45 In Chapter 1, we explained that there was a systemic inequality of arms between
leaseholders (as a group) and landlords (as a group), and we explain that further here.

3.46 If the parties do not reach agreement about the premium, a claim must be decided by
the Tribunal. As we have said above, litigation can be a lengthy, uncertain and
expensive process, with much at stake for both parties. That has various consequences.

3.47 First, landlords are often better able than leaseholders to incur the costs, and cope with
the uncertainty, of a Tribunal determination. It has been pointed out to us that, for a
landlord, the costs are a tax-deductible business expense; for ordinary leaseholders (as
opposed to buy-to-let investors), the costs must be paid from their post-tax earnings.

3.48 Second, a relatively small difference in premium for one individual claim can translate
into a much larger amount in the context of an entire building or estate. A landlord may
therefore decide to pursue a claim all the way to the Tribunal on a point of principle in
order to try to set a helpful precedent for future claims (for example, about capitalisation
rates, deferment rates and or relativity), even though the amount in dispute for that
particular claim may be low: see Figure 16.

Figure 16: what is at stake in a lease extension claim?

In a block of 100 flats, one leaseholder claims a lease extension.

The landlord’s valuer argues for a premium of £10,000. The leaseholder’s valuer argues for a
premium of £6,000.

From the leaseholder’s point of view, the dispute is worth £4,000.

From the landlord’s point of view, if the claim sets a precedent in the block, it could be worth
£400,000 (that is, £4,000 multiplied by 100 flats in the block).

If the legal and valuation costs of a Tribunal hearing would be £8,000 for each party:

- the best possible outcome for the leaseholder is a determined premium of £6,000 (giving a
total enfranchisement price of £14,000), so the leaseholder is better off accepting the
landlord’s valuer’s premium of £10,000.

- by contrast, from the landlord’s point of view, the claim could be worth £400,000, so it is well
worth incurring £8,000 of professional costs for a Tribunal determination.

3.49 The consequences are:

(1) The costs involved may be disproportionate (and sometimes higher than the
premium) for the leaseholder, but well worth incurring for the landlord. A
leaseholder may therefore agree to pay too high a premium to avoid the cost and
uncertainty of a Tribunal hearing, particularly as the decision may go against
them.
Even if the leaseholder does proceed to a Tribunal hearing, the decision is worth relatively little to the leaseholder and so it is not worth the leaseholder incurring significant costs. By contrast, the decision is worth a lot to the landlord, and so it is worth incurring significant costs to maximise the chances of a helpful decision. Stakeholders have complained that landlords are able to, and it is worthwhile for them to, engage the expensive services of Queen’s Counsel; doing so is beyond the reach of ordinary leaseholders and does not make financial sense, given (from their point of view) that a relatively low financial sum is at stake. The result is an inequality of arms between leaseholders and landlords.

The decision in Mundy involved a 9-day hearing, with numerous experts giving evidence. The case concerned three leaseholders. For them, the difference between their own valuer’s calculations (based on the Parthenia model) and the landlord’s valuer’s calculations (based on the Gerald Eve graph) was significant: in respect of two of the cases, the differences between the parties’ suggested premiums at the Tribunal were £89,750 and £54,000. But for the landlords involved, if the Parthenia model had been accepted, their income from other enfranchisement premiums would have greatly reduced, and therefore the value of their estates as a whole would have significantly reduced. So as far as the implications of the decision were concerned, the dispute at the Tribunal was worth £89,750 to one party (a leaseholder) but it was worth significantly more to the other party (a landlord).

In cases such as this: (1) leaseholders and landlords around the country have much to gain or lose from individual decisions, but (2) as for the individual parties themselves involved in the litigation, frequently it is the landlord who has the most to gain or lose, and so the greater financial incentive to litigate (and to spend significant sums of money on such litigation), owing to the wider implications of the decision for the landlord’s portfolio. The professional costs in such cases can be considerable.

In more typical enfranchisement claims, where the premiums are much lower than in Mundy (but which are still significant for the leaseholders concerned), the ability to instruct an array of professionals might be possible for landlords with a large portfolio, but is beyond the grasp of most leaseholders.

If the leaseholder does not wish to run the risk of, and incur the cost of, a Tribunal determination, and so instead agrees to pay the landlord’s proposed premium, that agreement can – in turn – be used by the landlord in future negotiations with other leaseholders as setting a precedent that supports their own figures.

Uncertainty being used as a bargaining counter

The uncertainty of outcome can be used by the commercially and financially stronger party as a bargaining counter against the weaker party.

For example, the deferment rate is, in theory, effectively set at 5% (for flats) and 4.75% (for houses) since the decision in Sportelli. But we have heard anecdotally that there remains scope to argue for a different rate, and in practice the uncertainty about which rate a Tribunal will accept can be used as a bargaining counter by landlords. We have heard of a landlord who routinely seeks a lower deferment rate (say, 3%) in its initial valuations and sometimes beyond that. Although the landlord will usually agree to the 5% Sportelli rate during the course of negotiations, there is uncertainty for the leaseholder as to whether the landlord is going to use their case to go the Tribunal to argue for 3%. If the landlord does so, the leaseholder (a) will have to incur substantial
legal costs, and (b) runs the risk that the Tribunal will decide the rate should be 3% rather than 5%, so the enfranchisement premium also goes up considerably. In these and other circumstances the threat of a Tribunal hearing and the risk of a disadvantageous outcome can cause anxiety for the leaseholder, and can be used by landlords as a bargaining counter in relation to other aspects of the claim. For example, leaseholders can be compelled to accept the landlord’s higher figures in relation to other aspects of the valuation (such as the landlord’s suggested capitalisation rate, or relativity percentage, or the landlord’s legal costs) in order to secure a settlement which avoids (a) the cost, and (b) the risk, of a Tribunal hearing about the deferment rate or any other aspect of the claim.

Problems for leaseholders with onerous ground rent obligations in their leases

3.52 Some leaseholders have leases that contain obligations to pay an onerous ground rent. There is no set definition of an onerous ground rent, though it seems to have become generally accepted in the market (reflecting a view that has conventionally been held by valuers for many years) that a ground rent above 0.1% of the property’s freehold value is onerous.\(^\text{78}\)

3.53 Onerous ground rents have been brought into sharp focus relatively recently following media coverage of the practice adopted by some developers of selling leases of new houses or flats under which the ground rent doubles every ten years. As a result, what looks at first glance to be a modest ground rent will become a substantial annual sum in the future. For example, where the initial rent is £295 and the lease provides for it to double every ten years, the rent will be £9,440 per annum by the 50\(^{th}\) anniversary – in other words, 32 times higher.

3.54 Such rent reviews make the need to enfranchise and buy out that ground rent more imperative, whilst at the same time significantly increasing the price the leaseholder has to pay to do so under current valuation methods: see paragraph 2.48 onwards above and House 4.

3.55 Although onerous ground rents have become particularly newsworthy recently, the existence of onerous ground rents is nothing new. There have been examples of leaseholders exercising enfranchisement rights in relation to older leases and having to pay a higher premium to reflect an onerous ground rent.\(^\text{79}\) Having said that, the financial

---

\(^{78}\) This view partially stems from the Tribunal’s decision in *Millard Investments Ltd v Cadogan* (LON/LVT/1756/04), but has been widely accepted. The Nationwide Building Society’s lending policy is not to lend on properties with a ground rent above 0.1% of the value of the property (see Consultation Paper, para 15.65). For a summary of some of the arguments about what amounts to an onerous ground rent, see *Leasehold Reform, Report of the Housing, Communities and Local Government Committee* (March 2019) HC 1468, paras 88 to 91, available at https://publications.parliament.uk/pa/cm201719/cmselect/cmmloc/1468/1468.pdf. The Tribunal’s decision in *Roberts v Fernandez* (LRA/14/2014) suggested that a ground rent above 0.21% of the property value was onerous. Ground rents which double frequently (e.g. every 10 years) are generally regarded as being onerous, and have been subject to Government intervention: see https://www.gov.uk/government/publications/leaseholder-pledge/public-pledge-for-leaseholders.

\(^{79}\) In relation to one of the flats in *Mundy*, for instance, over which a lease was granted in 1974, a deduction of £10,424 was made to the value of the lease to reflect the fact that it contained an onerous ground rent: *Trustees of the Sloane Stanley Estate v Mundy* [2016] UKUT 223 (LC) at [155]. And in *Millard Investments*
implications of onerous ground rents has not, historically, been anywhere near as significant as the financial implications of onerous ground rents which have been newsworthy more recently.

3.56 The current enfranchisement regime does not provide any assistance to leaseholders with onerous ground rents who are making an enfranchisement claim. They have to pay a sum to the landlord which reflects the onerous ground rent (since that is the landlord’s contractual entitlement). In addition, and many leaseholders would say perversely, the more onerous a ground rent obligation is (and so the more lucrative it is for a landlord), the lower the capitalisation rate that will be used to assess the premium (therefore making the premium even higher). There will also be an onerous ground rent adjustment that reduces the value of the existing lease, and increases both the marriage value and the premium.80

3.57 Leaseholders who have an onerous ground rent therefore face a series of compounding factors which result in very high premiums when they come to enfranchise: see paragraph 2.48 onwards above.

3.58 The enfranchisement premium for House 4, with its doubling ground rent, is extremely high. But it should not be assumed that the purpose of our project is simply to address problems faced by leaseholders with onerous ground rents. The complaints that leaseholders have about enfranchisement are applicable to all four of our worked examples. The scale of the problem is very pronounced in the case of a doubling ground rent, or other onerous ground rent, but the concerns that we heard about enfranchisement from leaseholders were held not only by those with onerous ground rents, but by leaseholders with a wide variety of leases.

Summary

3.59 The problems with the current enfranchisement regime outlined above cause unnecessary conflict, stress, uncertainty, costs, and delay. Ordinary leaseholders tend to be less able to shoulder these consequences than landlords. In addition, the incentive structures, inequality of arms and negotiating tactics that can be deployed create unfairness for the financially weaker party. The weaker party is usually the ordinary leaseholder rather than the landlord – though there are equally cases where the leaseholder is financially stronger (for example, an investor) and the landlord is financially weaker (for example, a leaseholder-owned company).

(3) ARGUMENTS FOR AND AGAINST REDUCING PREMIUMS

3.60 The policy objectives identified by Government and set out in our Terms of Reference are “to examine the options to reduce the premium payable by existing and future leaseholders to enfranchise”. It is no surprise that landlords raised objections to that decision in their consultation responses, and made detailed arguments about why in their view premiums should not be reduced. In this section, we summarise the arguments made by landlords. These arguments are important for Government to consider, given that the objective behind a decision to reduce premiums is significant to

80 See paras 2.22 onwards and 2.48 onwards.
the question of whether reducing premiums is compatible with A1P1. Counsel has advised:

A key factor affecting the compatibility of the scheme with A1P1 will be the aims and objectives of the eventual scheme. For example, if the primary aim of the scheme is to remedy perceived injustice faced by leaseholders, that will have a bearing on the scope of the reforms (including the identity of those who are to benefit from the reforms) and will feed into the assessment of proportionality, including the degree of scrutiny (or conversely, deference) the courts will apply to the scheme. If the Government’s aim is to reform the leasehold enfranchisement system in order to make enfranchisement more simple, quick and cost-effective, that will change the scope of the scheme and the proportionality assessment accordingly. If the Government’s aims are more ambitious – for example, deliberate redistribution of wealth from one group (landlords) to another (leaseholders) or even ending the system of leasehold altogether – that will also feed into the nature and scope of the scheme and the assessment of where the fair balance is to be struck in terms of compensation.

3.61 We did not ask any consultation questions about whether premiums should be reduced, since we are working within Terms of Reference which already set that objective. Leaseholders made general comments to us about the need to reduce enfranchisement premiums, but did not generally set out detailed arguments in favour of reducing premiums. That is unsurprising. There was no need for them to do so, since reducing premiums was the basis of our project in our Terms of Reference, and we did not ask any consultation questions about whether premiums should be reduced.

3.62 Accordingly, most of the arguments that we heard about whether premiums should be reduced, as a matter of principle, came from landlords who objected to that policy direction – and we summarise those arguments below. In the interests of balance, we also set out the counter-arguments that were raised with us, or could be raised, by leaseholders. Many of the arguments for and against reducing premiums do not correlate with each other, but where there are corresponding arguments and counter-arguments, we include cross-references to assist the reader. As explained above, we deliberately do not express a view on whether or not it is right to seek to reduce premiums, since that is a mixed question of law, valuation, social policy and – ultimately – political judgement. In our project, we have worked within Terms of Reference which ask us to examine the options to reduce premiums.

The competing interests of leaseholders and landlords

3.63 When it comes to enfranchisement premiums, the interests of the landlord and leaseholder are inevitably polarised. As noted in Chapter 1 and in paragraph 3.5 above, the leaseholder may feel that he or she should not have to pay for something that is already his or hers, or may feel that the premium payable is too high; the landlord may feel that he or she is entitled to the full market value for the property interest which is being compulsorily taken from him or her.

3.64 As we explained in the Consultation Paper, in drawing a balance between the competing interests of the landlord and leaseholder, the “original valuation basis” under the 1967 Act favoured the leaseholder. It was viewed by many as providing

---

81 Enfranchisement CP, para 14.91.
leaseholders, including some relatively wealthy leaseholders in Central London, with a windfall gain.

3.65 The various amendments to the 1967 Act and the introduction of the 1993 Act have shifted the balance between landlord and leaseholder, so that the subsequently introduced bases of valuation seek to compensate the landlord at full market value for the loss of the landlord’s interest. While there are many examples of landlords arguing that they have not been so compensated, leaseholders may argue that premiums are too high and do not reflect the fact that the asset they are buying is their home. In other words, leaseholders may feel that the pendulum has swung too far back in favour of landlords.

3.66 In addition, the discontent amongst leaseholders has been fuelled more recently by the practice of some developers – explained above – of selling leasehold properties with rent review clauses leading to very high ground rents. As well as leaseholders feeling stung simply by having to pay those onerous ground rents, they are also surprised to discover the financial consequences of such ground rent provisions feeding in to the valuation methodology. The current valuation methodology effectively endorses those onerous ground rent terms because it values the landlord’s actual contractual entitlement to ground rent.

Different types of leaseholders and landlords

3.67 In considering where the appropriate balance between the competing interests lies, it is necessary to consider the variety which exists amongst leaseholders and landlords:

(1) Landlords come in all shapes and sizes: private family estates (for example, the Grosvenor Estate and Cadogan Estate), charities (for example, the National Trust), developers, pension and other funds, private individuals, investors, and leaseholder-owned companies. From their point of view, they have investments which are being expropriated from them compulsorily. They are likely to object to any reduction in the premium.

(2) Leaseholders are also varied: ordinary homeowners (ranging from those with limited means through to very wealthy owners), non-resident owners (such as buy-to-let landlords, those with a second home, and those who have invested in property), and some speculative investors and developers who purchase flats with a view to exercising enfranchisement rights and profiting from selling on an enhanced interest. From their point of view, they have properties which are held on a leasehold basis for one of two reasons: either because the property is a flat, and leasehold is the standard method by which flats can be owned in England and Wales; or because the property is a house, but the developer insisted upon, or incentivised, the house being sold on a leasehold basis. They are likely to

82 Majority-leaseholder-owned companies are in a slightly different category from other kinds of landlord because, in some circumstances, their interests may more closely align with the interests of the leaseholders. But that will often not be the case, for example, where an enfranchising leaseholder is not a member of the company (because he or she did not participate in the collective enfranchisement that led to the company acquiring the freehold).
argue that the current basis for assessing premiums is “unfair” because the resulting premiums are too high.

3.68 Government’s desire – set out in our Terms of Reference – to reform the enfranchisement regime in order to provide a better deal for leaseholders as consumers is, of course, directed at individual homeowners rather than investors. However, any reduction in premium is likely to benefit all leaseholders.83

Landlords’ arguments against reducing premiums
(A) Unfairness

3.69 Landlords have said to us that it is unfair to reduce premiums. They relied on various arguments.

3.70 First, they have said that they have a valuable asset, and it is unfair to deprive them of that asset unless they are receiving compensation at market value. The strict position as a matter of property and contract law is that leaseholders have signed a lease, they will ordinarily have received legal advice (and in any event, bad legal advice does not invalidate a contract), and the terms of that lease are enforceable. Any compulsory purchase of the landlord’s property must be compensated at full open market value.

“... as a retired property developer, my pension is the ground rents on 53 flats. All of these flats were bought by [buy-to-let] investors. The ground rents were set at £150 pa or £250pa, increasing by RPI .... Thus, our ground rents are reasonable, and will stay reasonable in the future. All of our buyers had professional advisors – in every case. In the past I have been offered 36 times the ground rent to sell the freehold of this estate, and so any formula to reduce this value is a direct confiscation of my property. There is no justification for the Government to arbitrarily take money from my pension fund and give it to [buy-to-let] investors". (Bretton Green Ltd, a commercial investor)

(For a counter-argument, see paragraphs 3.88 to 3.90 below.)

3.71 Second, some landlords have explained the purpose for which they hold their freehold assets – such as to fund charitable work or to fund pensions. They have explained the negative impact on the future achievement of those purposes if premiums are reduced.

“All options suggested by the Law Commission, other than Option 2C [which is Scheme 3 in this Report], will have a considerable impact on the Wellcome’s charitable giving. That Option 1A [a ground rent multiplier] will be considered at all is abhorrent because of the significant negative impact that it would have on the value of Wellcome’s ground rented freehold investment assets: on the basis of a ten times multiplier, the day one value of the ground rented freehold properties in the Estate would fall by 97% (in excess of £100m). Even a multiplier of 100 times would reduce the day one value of the ground rented freehold properties by 71%". (The Wellcome Trust, charitable sector)

“The Charity only exists to give grants to benefit children and young people up to the age of 25 who live in nine boroughs in North and West London. To date, we have given over £110 million since 1991 to a range of organisations that seek to encourage the aspirations of children and young people through education in its widest sense. Enfranchisement proceeds make up a significant part of the capital required for our charitable giving. The proposed changes from the

---

83 We discuss the option of differential pricing for different types of leaseholder in para 6.180 onwards below.
Law Commission would dramatically affect our annual grant giving programme. While the Charity is a landlord, it is not profiting in the true sense from leaseholders as all proceeds are granted to charities, thereby performing a public benefit to the local community in London. Our fundamental objection to the proposals is on valuation. … I have undertaken detailed analysis on the Charity’s residential estate in St John’s Wood. All options are financially detrimental to the Charity. This would be catastrophic for the Charity and would result in the Charity’s activities being cut back at a time when demand for its services has never been greater.” (The John Lyon Charity, charitable sector)

“On behalf of its clients, Long Harbour has invested in UK ground rent portfolios valued in excess of £1.6bn, comprising over 160,000 leasehold properties, including some specialist age-restricted retirement housing. The funds invested are provided by regulated UK pensions and insurance companies and the income derived from the ground rents is used to service the retirement income of many thousands of pensioners…

The proposals for reducing premiums generally, and thus reducing what is currently fair compensation payable to Landlords enshrined in legislation are neither proportionate nor reflective of the current realities of the residential leasehold market. They would also result in a significant detriment to, and deprivation of reversionary interest value held by major institutional investors as UK pension assets for the ultimate benefit of a much larger body of private pensioner consumers…

We believe that the significant detriment that would result from reducing reversionary values, and thus appropriating value away from, amongst others, significant UK pension fund holdings benefitting hundreds of thousands of ordinary pensioners is a disproportionate response to address the need for reform of enfranchisement.” (Long Harbour and HomeGround, commercial investors)

Prescribing a capitalisation rate to reduce premiums “would have a catastrophic effect on the freehold ground rent sector and to the stakeholders that depend upon it, principally pension funds and insurance companies who would be required to impair their assets and reduce payments to their pensioners or annuity holders.” (Consensus Business Group, a commercial investor)

(For a counter-argument, see paragraph 3.91 below.)

3.72 Third, some landlords have explained that they are, in reality, a group of leaseholders, albeit wearing a different hat. For example, a group of leaseholders may have previously exercised their enfranchisement rights to acquire the freehold to their block, so they are now the landlord. If some leaseholders did not participate in the original enfranchisement claim (non-participating leaseholders), the participating leaseholders will themselves have had to fund the purchase price in respect of the non-participating leaseholders’ flats. They did so in the expectation that, when the non-participating leaseholders came to extend their leases, the participating leaseholders would receive the premium as repayment for the that extra sum that they originally paid to purchase the freehold. Accordingly, reducing premiums would cause detriment to leaseholders in a block which had previously exercised enfranchisement rights, to the benefit of leaseholders in the block who did not join in that previous enfranchisement claim.

“As an example, one of the (non-participating) apartments on our estate has a capital value of £600,000 and a current ground rent of £200 per annum, increasing to £600 per annum in December at the first review. Using the rates which applied to our enfranchisement (and which
we continue to use to calculate lease extension premiums, being 6.5% capitalisation and 5% deferment), the premium would be £12,785 (before any allowance for expenses), comprising £9,091 for the ground rent stream and £3,694 for the reversion. That compares to £2,000 under [Option 1A in the Consultation Paper]. (Southlands College Estate Wimbledon Limited, a leaseholder-owned freehold company)

(For a counter-argument, see paragraph 3.91 below.)

3.73 Fourth, some landlords explained that leaseholders are often well-advised, knowledgeable, and wealthy, and that they can currently take advantage of the enfranchisement legislation to make a profit. Some leaseholders are investors. All of these leaseholders would be benefited – unfairly and unnecessarily, in their view – by a reduction in premiums. Reducing premiums would involve a reallocation of wealth from (for example) charities and pension funds to (for example) buy-to-let investors.

“As in other areas of Prime Central London those buying leasehold properties on the John Lyon Estate are not ill-advised, naïve buyers but sophisticated, professionally-advised customers often with a detailed knowledge of the Prime Central London property market who understand that they are buying a time limited interest. Given the nature of the Charity’s residential portfolio if the valuation changes are introduced, a small, very wealthy percentage of its inhabitants will pay substantially less for extending their leases or obtaining their freeholds, directly impacting upon the Charity’s ability to help those children and young people most in need”. (John Lyon Charity, charitable sector)

“For the numerous commercial investors who use enfranchisement to disenfranchise a different class of commercial investor then the current methodology of calculating premiums works massively in their favour. It speeds up the number of enfranchisement cases, prevents none and the profits the investors will make far outweigh the costs of so doing.” (Geraint Evans, surveyor)

3.74 Fifth, it has been argued that reducing enfranchisement premiums is inappropriate because it would result in windfall gains for existing leaseholders, and no benefit to future leasehold purchasers. That is because lower enfranchisement premiums will result in the value of existing leases increasing: see our explanation of the circularity problem in paragraphs 3.20 and Figure 13 above. So future leaseholders will not benefit from reduced premiums because any reduced premium will have resulted in a corresponding increase in the initial purchase price that they paid for the property: see Figure 17 below.

**Figure 17: reducing premiums benefitting existing, but not future, leaseholders**

Take a leasehold flat which would be worth £225,000 if held on a long lease.

In fact, only 70 years remain and the premium for a lease extension will be £20,000.

A purchaser will therefore only pay £205,000 for the lease. That is because the purchaser will have to pay to extend the lease, and so the total cost of acquiring a long lease of the flat will be £225,000 – namely a £205,000 purchase price plus £20,000 enfranchisement premium.

If enfranchisement premiums are reduced, so that the lease extension will now only cost £10,000, then the purchaser would pay £215,000 for the lease. The total cost to the purchaser of acquiring a long lease of the flat will still be £225,000. But the existing leaseholder will have sold the flat for a higher sum (£215,000 rather than £205,000). That increased sale price reflects the fact that the incoming purchaser will be paying a reduced enfranchisement premium.
3.75 Sixth, it was argued that standardising the rates used in the valuation process at either market-rates or below-market rates would fail to take into account the low-risk nature of investing in freeholds.

"The income from reversions is essentially risk free, because non-payment of rent can lead to forfeiture. An assiduous (and litigious) landlord will nearly always get his or her rent from the leaseholder and, if he or she does not, he or she will end up with a windfall gain through forfeiture. The windfall gain will usually exceed the capital value of the reversion many times over: for example, if a landlord has paid in the wholesale market, say, £6,250 for a reversion generating a fixed ground rent of £250 p.a. and the leaseholder fails to pay the rent so that the leaseholder’s interest is forfeited, the landlord could end up with a property worth (say) £150,000, which would be 24 times the landlord’s original investment. Nothing like that can happen in the world of bonds. Essentially the income from reversions is risk free: indeed, a mercenary landlord may well welcome default on the part of leaseholders as an opportunity to maximise returns on his or her investment". (Tapestart Limited, a commercial investor)

(B) Impact on the economy

Leaking of wealth out of England and Wales if reforms benefit commercial investors

3.76 Some consultees said that, if premiums are reduced for commercial investors, wealth will leak out of England and Wales.

"Pursuing an option which makes the enfranchisement price cheaper, will result in a one-off transfer of equity from present freeholders to present leaseholders. For central London, which is a market that is overrepresented by overseas investors, there may be a resulting leakage of wealth out of the UK". (Cluttons, surveyors)

Reducing enfranchisement premiums would increase the value of existing leases, which in many cases would "disproportionately benefit overseas and domestic investors given the make-up of our market" (Cadogan Estate, landlord).

Reputation of the property market

3.77 Some consultees said that legislative intervention would threaten the reputation of the property market.

"The UK is (so far rightly) widely perceived throughout the world as a country subject to a stable legal system and therefore a safe place to do business. Any legislation which in effect tears up contracts which have been freely entered by willing buyers and sellers will put the UK in the same category of the many foreign countries that cannot be trusted to provide a stable environment in which to do business". (Consensus Business Group, a commercial investor)

"There are also a number of foreign controlled funds who have invested on the basis of stable law and stable institutions in this country, and it is likely to be the case that any shift in value from landlords to lessees is likely to damage this country's international reputation as a safe haven for investors". (Morgoed Investments Ltd, a commercial investor)

Tax revenue for Government through Stamp Duty Land Tax

3.78 Some landlords argued that reducing premiums should not be permitted because it would reduce the tax revenue from Stamp Duty Land Tax.
Leaseholders’ arguments in favour of reducing premiums

3.79 Leaseholders made various comments supporting a reduction in premiums. Some leaseholders also expressed their disagreement with arguments made by landlords about unfairness to them.

Cost is prohibitive

3.80 Very many leaseholders have said to us that enfranchisement premiums are too high. In our Leaseholder Survey, for example, we asked leaseholders who had considered exercising enfranchisement rights but then decided not to do so (or were unable to do so) why that was the case. Nearly 1,000 leaseholders responded, and the most common reason given for their decision not to (or inability to) exercise their enfranchisement rights was the price. There are clearly many leaseholders in England and Wales who would like to exercise their enfranchisement rights but the likely premiums are too expensive for them to be able to do so.

3.81 The inability to enfranchise means that leaseholders may be compelled to sell the lease to someone who would be able to pay to enfranchise in order to preserve the lease. The alternative would be for the term of the lease to come to an end, in which case the property would return to the landlord, and the leaseholder would be left without their home.

“We wanted to enfranchise but were dissuaded by costs and the time it would take … ”. (A leaseholder responding to our survey)

“The current methodology has prevented thousands of leaseholders from enfranchising”. (National Leasehold Campaign, a leaseholder representative body)

The current valuation methodology “has had an incalculable effect on the cost of lease extensions and the legal costs payable by leaseholders … . Freeholders have made billions using the courts to extort money from leaseholders for hundreds of years. It is a national embarrassment”. (Leasehold Knowledge Partnership, a leaseholder representative body)

The current valuation methodology “has made it far too contentious and the increased professional fees have deterred many leaseholders from extending their lease or enfranchising”. (Parthenia, surveyors)

“The cost of extending this lease would be totally unaffordable although I have owned this property since 1976 (lease length was 98 years at time of purchase). I have used lease extension calculator available online … and the cost including paying for the freeholder and my solicitor plus surveyor would be around £65,000!!!!” (A leaseholder responding to our survey)

“It was far too expensive!!! My 97 year old partner bought this flat in 1994 for £95,000. Now after living in our home for 25 years, the landlord claimed he was 'retiring' last January 2017 and offered to sell us the freehold for almost £20,000!!! So we have invested and protected our home for that time and now we are expected to buy our home yet again for almost 20% of the original purchase price. How is that even fair or moral?” (A leaseholder responding to our survey)
Inherent unfairness of leasehold ownership

3.82 We have already explained, in paragraph 3.4 onwards above, the common argument made by leaseholders that leasehold ownership is inherently unfair. That, in itself, is put forward as an argument by leaseholders in favour of reducing premiums, since reducing premiums would go some way to addressing that inherent unfairness.

Political and social policy arguments

3.83 Various political and social policy arguments can be made in favour of reducing premiums.

3.84 First, there are social policy and political arguments about the importance of the home, and the fact that long leasehold ownership does not provide the level of security that home-ownership should provide. Such arguments can be raised to justify lower premiums, alongside enhanced enfranchisement rights (which will be considered in our second report on enfranchisement reform).

3.85 Second, policy aims of improving the housing stock and ensuring the liquidity of the housing market could justify lower premiums. An enfranchisement claim “improves” the quality of the asset owned by the leaseholder, and therefore makes it more attractive to potential purchasers, and more attractive to lenders as security for mortgages. Reducing enfranchisement premiums will make claims by leaseholders more likely, thereby improving the quality of the assets owned by homeowners and, in turn, the liquidity of the housing market.

3.86 Third, leasehold homes are an asset class to landlords.

(1) Landlords derive income from (for example) the ground rent and enfranchisement premiums, and often in other ways (such as charging permission fees to leaseholders, which can be permitted by the terms of the lease).

(2) Landlords often trade these assets – the freeholds – with other investors, very often without the leaseholders’ knowledge.  

3.87 Many leaseholders object to their home, which is their place of shelter, safety and security, being used as a source of profit by an external landlord. They feel that they have purchased their home, and it is not acceptable that someone else has a significant financial stake in their home. Leaseholders would say that they purchased a leasehold, rather than a freehold, home because that is all that was on offer – and in the case of flats, that is the only ownership mechanism generally available in the market (see paragraph 1.12 and Figure 1 above). By purchasing a leasehold property, they were not (either willingly or knowingly) agreeing to “share” their financial stake in their home with an external investor. Enfranchisement claims involve shifting the landlords’

84 Leaseholders of flats have a “right of first refusal” under the Landlord and Tenant Act 1987 if the landlord sells the freehold. However, the right is very easily avoided by landlords, and there is no equivalent right for leaseholders of houses.

85 Commonhold, which enables freehold ownership of flats, is currently rarely available. It is the subject of a separate Law Commission project. We published our consultation paper, Reinvigorating commonhold: the alternative to leasehold ownership (2018) Law Commission Consultation Paper No 241, on 10 December 2018 and will publish our report later this year.
financial interest in a property to the leaseholder, either completely (in the case of a freehold purchase) or very significantly (in the case of a lease extension at a peppercorn ground rent). So reducing premiums will allow leaseholders – more often and more cheaply – to correct the perceived injustice of landlords having a significant financial stake in their homes, since that financial stake will (largely or entirely) be transferred to the leaseholder.

"We leaseholders had no idea that we were somebody's investment and nowhere in any lease is such a situation referred to." (A leaseholder responding to our survey)

"We do not think it is appropriate to use home owners as a source of continuing profit simply because they are leaseholders rather than freeholders … ". (National Housing Federation)

Leaseholders are not voluntarily acquiring an enhanced asset

(For a counter-argument, see paragraph 3.70 above.)

3.88 Leaseholders often say that enfranchisement is "too expensive". Landlords might respond to such arguments by saying that many things might be too expensive, and therefore beyond the reach, of certain individuals. House prices, for example, are often said to be too high for first-time buyers.

3.89 But, arguably, the analogy is not an appropriate one. When first-time buyers purchase a home, they are seeking for the first time to acquire an asset: they go from the position of not owning their home to owning their home. Leaseholders exercising enfranchisement rights in respect of their home are not in the same position. Rather, they have already purchased their home, paying a large sum to do so, and often having had no choice over whether to buy the freehold of their home rather than the leasehold. The need to make an enfranchisement claim arises not because they voluntarily decide that they want to improve the value of their asset, but because they are compelled to engage with a process to avoid the loss, or de-valuation, of their home.

3.90 So, whilst the traditional view – and property lawyers' and valuers' view – of an enfranchisement claim is the acquisition by the leaseholder of a property right belonging to the landlord, in fact an enfranchisement claim could equally – as a matter of housing and social policy – be seen as akin to an administrative charge which comes with owning a particular type of home, and that the fee is too high when compared to the service that the leaseholder receives.

Identity of landlord irrelevant for leaseholders

(For a counter-argument, see paragraphs 3.71 and 3.72 above.)

3.91 Leaseholders could argue that, if they are paying an enfranchisement premium, it is largely irrelevant who their landlord is and what they use the income for. Whether enfranchisement premiums are paid to large or small, commercial or not-for-profit, or co-operative or exploitative landlords, ultimately leaseholders are having to pay the same sum of money to rectify the problems associated with owning a time-limited asset. So reducing premiums is not about different types of deserving or undeserving landlord (however that may be defined), but rather about acknowledging a systemic problem with leasehold ownership, with the requirement for leaseholders to “pay twice” for their
home. The impact on the leaseholder of the requirement to pay enfranchisement premiums is the same, regardless of the landlord’s identity.

Reducing premiums does benefit future leaseholders

(For a counter-argument, see paragraph 3.74 above.)

3.92 We explained above the argument that only existing leaseholders would benefit from reduced premiums, and that future leaseholders would not. The argument is that the sale price that would be obtained by existing leaseholders is the value of a long lease less the enfranchisement premium. The effect of reducing premiums is that the sale price that would be obtained by existing leaseholders would increase, because the purchaser would pay the same amount overall. Accordingly, existing leaseholders would benefit from reduced premiums because the value of their lease would increase, but future leaseholders would not benefit because the total price that they pay (the purchase price to the vendor plus the enfranchisement premium to the landlord) would stay the same: see Figure 17 above.

3.93 In response to that, leaseholders could point out that there are at least 4.2 million existing leaseholders and argue that that constitutes a substantial number of home owners who would still stand to benefit. But even if future leaseholders would not benefit from reform and would end up paying more when acquiring a lease (reflecting the fact that they will now pay less by way of an enfranchisement premium), it is arguable that there are significant benefits to those future leaseholders not encountering unexpected and expensive enfranchisement premiums further down the line. All leaseholders will know the initial purchase price for the property and they will budget accordingly. By contrast, leaseholders may not know about the need to enfranchise at a later date, and they will definitely not know with any certainty what premium they will have to pay (see paragraph 3.29 onwards above). So reduced enfranchisement premiums still have significant benefits for future leaseholders even if – taken together – the purchase price plus enfranchisement premium end up being broadly similar. That is because future leaseholders will not have to shoulder such unexpected, expensive and uncertain premiums – which they may not be able to afford.

The value of landlords’ assets can already go up or down

3.94 Leaseholders suggested that, since landlords are investing in an asset, they should not be surprised that the value of that investment could go down – just as the value of many other types of investment can go down. Even under the current valuation regime, the value of landlords’ assets can change.

(1) Since markets change, it is inherent that “market value” can vary over time. For example:

(a) If there are changes in the economy (for example, if interest rates change), there can be consequential changes to (say) capitalisation rates, which in turn will change the value of landlords’ assets.

(b) A change in property prices will affect the value of landlords’ assets (in so far as they have any reversionary value).
(2) The value of landlords’ assets can change as a result of significant Tribunal or court decisions. For example:

(a) Prior to the decision in *Sportelli*, deferment rates were commonly around 6% in London and 7% elsewhere. Following *Sportelli*, the rate was reduced to 5% (or 4.75% for houses), which resulted in enfranchisement premiums rising significantly, and consequentially the value of landlords’ assets increasing overnight.

(b) In *Mundy*, had the Tribunal or court accepted the Parthenia model to assess relativity, enfranchisement premiums (in so far as they comprise marriage value) would – in general – have reduced, and consequently the value of many landlords’ assets would have been significantly reduced overnight.

3.95 So, a change in the value of assets is to be expected, and is part of the risk of owning any asset.

3.96 Moreover, landlords cannot assume that the existing valuation methodology, or existing legal regime, will continue indefinitely. The introduction of the first enfranchisement legislation in 1967 (which provided a favourable basis of valuation to leaseholders) would have significantly reduced the value of many landlords’ assets. Similarly, when the enfranchisement regime was extended to flats in 1993 and further expanded in 2002, that had significant implications for landlords. The law is reformed, and that has implications for very many people. Landlords cannot expect that the current valuation methodology will always remain the same. When investing, it is standard practice to consider the risk, and make allowances for risk. For example:

(1) there is a risk of higher taxes being levied on property owners who are not owner-occupiers; and

(2) when landlords have invested in ground rents, particularly onerous ground rents, they should have considered the risk of future regulatory intervention which could reduce their contractual entitlement to the ground rent.

---

86 By the Leasehold Reform, Housing and Urban Development Act 1993, and the Commonhold and Leasehold Reform Act 2002.
The valuation of enfranchisement premiums – through the capitalisation rate – reflects the level of risk of investing in that particular asset. Some consultees argued that prescribing the capitalisation rate risked de-valuing landlords' assets by failing to reflect the risk-free nature of the asset: see paragraph 3.75 above.

We noted in paragraph 3.96 above the risk of regulatory intervention in respect of onerous ground rents. The risk of regulatory intervention in fact goes further.

The argument set out in paragraph 3.75 above is that investing in freeholds is currently a risk-free investment since leaseholders who do not pay their ground rent can have their lease forfeited by their landlord, which results in a windfall gain to the landlord.

We have in the past recommended that forfeiture be abolished and replaced with a proportionate regime to address any failure by leaseholders to comply with the terms of their lease. So, for example, if leaseholders do not pay their ground rent, landlords would have to commence a process to enforce the payment obligation against the leaseholder, and the ultimate sanction would be an order requiring the lease to be sold to pay the debt to the landlord, but with the equity going to the leaseholder; landlords would no longer receive windfall gains. The consequence of implementation of our recommendations would be to remove the windfall gain for landlords and the sword of Damocles that currently looms over leaseholders. That would, on the argument set out in paragraph 3.75 above, reduce the risk-free nature of investing in freeholds.

So the level of risk associated with investing in freeholds, from a landlord's point of view, is already liable to change at any point – indeed, we have recommended a change that would have that effect.

3.97 Essentially, there is no guarantee under the current law that the value of landlords' assets will always stay the same, or go up – the value of their assets can fluctuate. And there is no guarantee that the level of risk associated with holding a particular type of asset will always stay the same.

3.98 Landlords, of course, do not want premiums to reduce, and they may argue that the problems leaseholders face are caused simply by bad advice from their lawyers or valuers. But conversely, landlords' assets are not risk-free, and leaseholders can equally argue that any unexpected reduction in the value of landlords' assets is caused by bad investment advice obtained by landlords about the risk of owning such assets.

"If professional freeholders invest in a morally questionable asset class they should not be surprised if the value of that asset class reduces when people wake up to the underlying issues; this is no different to any other equity type investment value falling where the company or industry is involved in a scandal. It will doubtless form part of their responses but role of the morally questionably practices needs to be remembered. No compensation should be paid for loss of permission fees. The primacy of the home "owner" needs to be foremost over the speculator using that home as an asset class. Ground rent fees other than peppercorn serve no purpose beyond creating an asset class out of a home". (Michael Kelly, a leaseholder)

Requirement to pay marriage value

3.99 Leaseholders with less than 80 years remaining on their lease are required to pay marriage value. If the freehold were to be purchased by an external investor, that investor would not pay marriage value – and so the price would be lower. Leaseholders would say that it is unfair that they have to pay more to exercise enfranchisement rights than an external investor would pay in the open market for the same asset; they are being penalised for being the leaseholder. We explore this argument further in our discussions of Schemes 1 and 2 in Chapter 5.

“Our lease had 61 years remaining which incurred the further legal penalty of ‘Marriage Value’. This is an inexplicable artifice of no merit other than to serve as a penalty to longstanding leaseholders”. (A leaseholder responding to our survey).
INTRODUCTION

4.1 We said in Chapter 1 that our task is to set out the options that are available to Government for reducing premiums payable by leaseholders. We explained that, as our Terms of Reference make clear, it is not our role to decide whether or not premiums should be reduced since that question involves considerations of law, valuation, social policy, and, ultimately, political judgement. As a law reform body, we can guide Government as to which option to take forward only in so far as Government’s decision raises legal questions, including compatibility with A1P1.

4.2 Before setting out the options for reducing premiums, we explain in this chapter what our role does, and does not, involve.

SETTING THE LEGAL FRAMEWORK AND PROCESS FOR VALUATION

4.3 Our task is to set out the options for a new legal framework for the valuation of enfranchisement premiums, including the process that must be followed to set enfranchisement premiums. Therefore, we comment on what the legal framework should seek to achieve and how it should do that. By contrast, it is not for us to comment on the precise answer that the framework should generate in given cases. Accordingly, we do not comment (for example) on what is the correct valuation technique to assess the “market value”, nor on what figure is the correct capitalisation rate, save in relation to questions of whether such techniques are legal. For the purposes of explanation, we reflect that distinction by referring to:

(1) setting the legal framework, which is part of our role; and

(2) setting the valuation methodology within (and the outputs generated by) that framework, which is not part of our role.

THE ROUTE TO VALUATION REFORM

4.4 Broadly speaking, reforming the valuation regime will require Government to address four principal questions.

(1) What should the overall valuation framework be?

4.5 The first question is: what should the overall valuation framework be? This is a legal question on which we comment throughout this Report. In particular, in Chapter 5, we discuss – and ultimately reject – frameworks based on simple formulae. Instead, we put forward three possible schemes, all of which are based on the market value of the asset. It is for Government to decide whether, and if so which, of these overall valuation frameworks to adopt.
4.6 In addition, all of the "sub-options" that we discuss in Chapter 6 could form part of the overall valuation framework. These sub-options all involve legal questions on which we comment, and on which it is for Government to make a final decision.

(2) What is the correct methodology for assessing “market value”?

4.7 Assuming Government decides that the overall valuation framework should be based on market value, the second question is what the correct methodology is for assessing market value. This is a valuation question (and partly a political question) on which we cannot comment. But it is something that Government might have to decide.

4.8 The current enfranchisement legislation does not set out what valuation methodology must be adopted. All it requires is an assessment of the market value of the landlord’s interest: see paragraph 2.11. Valuers almost always adopt the conventional valuation methodology that we set out in Chapter 2. In Chapter 6, we discuss the possibility of prescribing the rates that are used in that conventional methodology. If Government wants to prescribe those rates, it must also – as a preliminary step – establish that conventional methodology as the sole means by which enfranchisement premiums can be calculated. There is little point prescribing rates under the conventional methodology if valuers would then be free to bypass those prescribed rates by arguing for an altogether different valuation methodology which does not require those rates to be used.

4.9 Accordingly, although we cannot comment on what is the “correct” methodology to assess the market value of an asset, if Government wishes to prescribe rates it must also provide in statute the permitted methodology to assess the market value of an asset, and mandate the use of that methodology. In Chapter 5, we set out three possible valuation Schemes. If Government decides that one of those Schemes should be adopted and that, within it, rates should be prescribed, then Government will also need to create a requirement in the legislation that the conventional valuation methodology be used in all cases. That is because the prescribed rates are only of relevance if that conventional valuation methodology for assessing market value is used.

4.10 In this Report, we proceed on the assumption that, if Government wants premiums to be based on market value, and if it wants to prescribe rates, then it will do so according to the conventional valuation methodology. If, instead, Government wishes to explore whether other valuation methodologies could be used to assess market value (as suggested by some consultees: see paragraphs 2.62 above and 4.15 below), Government would need to assess whether those valuation methodologies are appropriate and whether and how rates could be prescribed within them. The decision to adopt a new valuation methodology would raise valuation and economic questions on which we cannot comment.

88 We explain in para 2.61 that a different methodology could be adopted in order to calculate the market value. If the conventional valuation methodology were mandated in all cases, then it would mean that an enfranchisement premium could not be set (for example) by reference to a recent local comparable transaction, since that would be an alternative means of assessing the market value. However, going through the conventional valuation methodology should logically produce broadly the same result.
(3) If rates are prescribed, by what process should they be set?

4.11 If Government decides to require the conventional valuation methodology to be used in all cases, and decides to prescribe the rates within it, the third question is: by what process should the rates be set? This is a legal question on which we comment in Chapter 6 in so far as (a) it goes to what the legislation needs to say in order to achieve the aim of prescribing rates, and (b) it involves the identification, as a matter of law, of what process and procedure must be followed in order to make that decision. We discuss who could set rates and how they could do it. It is then for Government to make a final decision about what process to adopt.

(4) If rates are prescribed, what should the rates be?

4.12 If rates are to be prescribed, the fourth question is at what level (or levels) they should be set. This is a valuation and political question on which we cannot comment. If rates are to be prescribed at a level that is intended to reflect market values, then the correct rate is a question of valuation. If rates are to be prescribed at below-market levels, then the correct rate is also a political question. Depending on the process that is adopted (in response to the third question above), it is a question on which Government might have to make a decision.

CONSULTATION RESPONSES ABOUT VALUATION METHODOLOGY

4.13 In the Consultation Paper, we asked questions about what a new legal framework for the valuation of enfranchisement premiums should be, and consultees provided helpful responses to those questions. Understandably, many consultees also commented on valuation methodology, as we now go on to explain. For the reasons set out above, it is not our role to comment on valuation methodology.

The correct method for assessing market value

4.14 As explained above, the conventional practice of valuers specialising in the enfranchisement field has been to assess the market value of the landlord’s interest by following the methodology that was set out in Chapter 2.

4.15 A few consultees argued that a different approach should be used to assess the market value of a landlord’s asset, and therefore enfranchisement premiums.

Dean Buckner, in a response supported by the Leasehold Knowledge Partnership and the co-chairs of the All-Party Parliamentary Group on Leasehold and Commonhold Reform, said that:

“The concept of marriage value, namely the supposed additional value an interest in land gains when the lessor’s and the lessee’s separate interests are married into single ownership, is economically incoherent. The implied market value of the two interests (leasehold and freehold) is equal to the implied market value of the interest with vacant possession.

A single deferment rate therefore determines the value of both freehold and leasehold interests. The deferment rate is defined as the discount rate that when applied the freehold price of vacant possession results in the price of deferred possession or freehold price, and which by implication defines the price of the corresponding leasehold value. Using a single rate for both freehold and leasehold, i.e. by assuming that marriage value is already embedded in the price of both, simplifies the cost of leasehold extension and enfranchisement.
The deferment rate can be simply estimated from the net rental income from the property (i.e. gross income net of management, void and maintenance costs), using the standard dividend discount model. A simpler method benefits lessees who typically find the cost of subjective ‘professional’ advice prohibitive”.

He concluded that the deferment rate should be between 3.3% (in Durham, Southampton, Cumbria (Carlisle) and Leeds) and 6.9% (in Sunderland).

Rothesay Life PLC also made specific suggestions relating to the valuation methodology.

First, Rothesay Life PLC said that capitalisation and deferment rates should be prescribed, and that “to facilitate the prescription of the capitalisation rate, and to improve the accuracy of the term valuation for inflation linked leases, we propose that, when determining the capitalised ground rent for an inflation linked lease, inflation-linked leases are treated in the same manner as leases with other types of review. This approach would require that the expected future rent for inflation linked leases (i.e. leases that are linked to CPI, RPI or the capital value of the property) be projected through assuming a long-term inflation rate for that index. We recommend that such long-term inflation rates are also prescribed and updated with the same frequency as other rates (capitalisation, deferment etc)”.

Second, it was argued that marriage value for lease terms of less than 80 years could be replaced with an altered deferment rate:

“Our suggestion is that a lower deferment rate of x% could be used at 21 years, interpolating upward linearly to the current deferment rate of 5% at 80 years and above (with each rate being updated from time to time). As for the setting of a lower deferment rate x, we would favour the selection of 2.25% based on the independent recommendation from Oxford Economics for what would currently be the appropriate deferment rate (for all tenors) based on the same framework as used in Sportelli: The proposal to interpolate up to 5% at 80 years (rather than introduce a rate of 2.25% for all tenors, as Oxford recommend is appropriate) is made in recognition of the Law Commission’s terms of reference to provide a better deal for leaseholder as consumers (i.e. to ensure decreases, rather than increases, in premium for the vast majority of leaseholders)”.

4.16 These suggestions raise questions about the correct economic model to use in order to assess the market value of a landlord’s interest. It calls into question the conventional approach that has, until now, been adopted by valuers in the field. These suggestions raise both valuation and wider economic arguments. They form part of question (2) above (see paragraphs 4.7 to 4.10) and are not something on which we, as a body of lawyers, can express a view.

The correct rate or relativity graph

4.17 As explained in Chapter 2, the conventional valuation methodology requires valuers to decide the most appropriate capitalisation and deferment rate, and, where marriage value is payable, the value of the existing lease, which involves either deciding on an appropriate relativity or no-Act deduction.

4.18 Many consultees commented that the capitalisation or deferment rate should be set at a particular level.89

---

89 References to “PCL” are to “Prime Central London”: see Glossary.
Comments on capitalisation rates

“We think the capitalisation rate should initially be set for PCL at 5%, and reviewed by a panel of experts at five-yearly intervals”. (Grosvenor, landlord)

“If capitalisation rates are set, they need to reflect the capitalisation rates that have been used in recent years for valuation purposes; 7-8% to ensure that enfranchisement premiums are attainable for leaseholders”. (National Leasehold Campaign, a leaseholder representative body)

“Cap rates need to be prescribed as a matter of urgency... The rates should be prescribed as they have historically been at between 8-9%”. (Leasehold Knowledge Partnership, a leaseholder representative body)

“Capitalisation Rates should be fixed at 10%”. (Millbrooke Court Residents Association, a leaseholder representative body)

“We believe the capitalization rate should be set according to long term financial data and correspond to the lease term. We know investors require a premium over and above the Bank of England rate and this may be circa 3%. Therefore, rates should be reflective i.e. average interest rate over the last ten years is circa 0.5% and therefore for a lease of ten years the rate is set at 3.5% and for a lease of 100 years it might be 9% (long term average Bank base rate of circa 6% for last 100 years plus 3% premium). This would mean capitalization rates will vary for short leases according to fluctuations in the Bank base rate, which is what happens now”. (Parthenia, surveyors)

“If you start with the premise the RPI reviews should be linked to the risk free rate, say for 30 year GILTS (currently 1.5%). Add in cost of collection at another 1.5% so 3% is lowest cap rate. So for example

(a) RPI with % increase every review (RPI + 2% every 5 years) should 3% cap rate (100%).

(b) RPI without % increase should be 3.5% cap rate.

(c) Doubling less then every 22 years should be 5% cap rate.

(d) Increasing by original sum less than every 22 years or doubling every 22+ years should be 6% cap rate.

(e) Increasing by original sum more than every 22 years should be 7% cap rate.

(f) Fixed ground rent should be 9% cap rate”. (Xuxax Ltd, a commercial investor)

Comments on deferment rates

“If a deferment rate has to be prescribed it should be done so to reduce the payments due by leaseholders as this is clearly in the public interest. We suggest 6% in PCL and 6.5% for the rest of the country”. (Leasehold Knowledge Partnership, a leaseholder representative body)

“We believe 10% is the correct figure”. (Millbrooke Court Residents Association, a leaseholder representative body)

“Where the leases are long, say, over 20 years, the rates could be prescribed at, say, 4.75% for houses and 5% for flats. One proposal is that flats and houses should be treated the same
as far as eligibility is concerned, but in fact the distinction as far as deferment rate is concerned is based on sound valuation principle, namely, that flats involve more management than houses, and the extra 0.25% reflects that extra cost". (Church Commissioners for England)

“We think the deferment rate should initially be set for PCL at 2.25% (in line with current residential market yields in PCL) and reviewed on the same basis as the prescribed capitalisation rate. It would be fair to adopt higher deferment rates for properties outside PCL to reflect the lower historic growth rates and the greater risk of deterioration and obsolescence, which has been acknowledged in a number of Tribunal cases". (Grosvenor, landlord)

4.19 Other consultees commented that relativity should be set by reference to a particular graph or a particular model.

“The easiest way to prescribe is to adopt one of the graphs of relativity which have been devised by firms that specialise in this area. Following the test case of Mundy, where all the graphs were considered, we would favour the adoption of the Gerald Eve 1996 graph”. (John Lyon’s Charity, charitable sector)

“Relativity may have changed, but we do not know how and the freeholders continue to rely upon the Gerald Eve graph which uses data from the 1970s. We have offered the Parthenia dataset to the Government and this would allow them to set relativity for the entire market (relativity is a ratio and is therefore not geographically dependent)”. (Parthenia, surveyors)

4.20 These comments from consultees about how these rates should be set reflect different views amongst valuers as to the correct figure to use when undertaking the conventional valuation.

4.21 These suggestions raise questions of valuation. They form part of question (4) above (see paragraph 4.12) and are not something on which we, as a body of lawyers, can express a view.

4.22 The “correct” capitalisation rate to adopt can be the subject of disagreement between professional valuers, which sometimes has to be resolved by the Tribunal hearing evidence and deciding which professional’s opinion to accept. Until fairly recently, capitalisation rates were usually agreed or decided by the Tribunal in the range of 5-7%, but a recent Tribunal decision found that the appropriate capitalisation rate in that case was 3.35%.90 It is not appropriate for us to decide whether 3%, 5%, 7% or any other percentage is the correct capitalisation rate generally or for any particular area or property. While Tribunals do make decisions about which rate is correct, that is not our role. And in any event, Tribunals make their decisions about which rate is correct on the basis of the evidence put before them by valuers on a case-by-case basis. That is different from setting a prescribed rate to be used in all cases, the purpose of which includes the avoidance of litigation before the Tribunal.

4.23 The “correct” relativity percentage to use can also be the subject of disagreement between professional valuers. Indeed, as set out at Figure 7 in Chapter 2 above, the Tribunal and then the Court of Appeal recently considered extensive evidence from valuation professionals as to which model should be used. The case considered a variety of graphs that have been prepared by different firms over the years, and a new

90 St Emmanuuel House (Freehold) Ltd v Berkeley Seventy-Six Ltd CHI/21UC/OCE/2017/0025. See also para 6.63 below.
model for assessing relativity, called the Parthenia model. After lengthy and technical evidence from a variety of experts, the Tribunal (and subsequently the Court of Appeal) concluded that the assessment of relativity depends on the individual facts of each case, but went on to reject the Parthenia model, concluding that the Gerald Eve graph, in this case, was “the least unreliable”.91

4.24 The different views about the appropriate rates is one of the problems with the current valuation regime that we discussed in Chapter 3, and is one of the arguments in favour of prescribing rates. Whilst it is not for us to comment on what the rate should be, we do comment in Chapter 6 on the process by which they could be prescribed – which is part of question (3) above (see paragraphs 4.11).

CONCLUSION

4.25 Our Terms of Reference require us to set out options to reduce the price payable while providing sufficient compensation for landlords. In doing so, we consider options for the creation of a new legal framework for valuation, including the process that must be followed to set premiums. We address the legal questions that must be considered in creating that framework, including compatibility with A1P1. That is the focus of the remainder of this Report, and is what the overall schemes and the various sub-options – which we set out in Chapters 5 and 6 respectively – would achieve. We do not comment further on the appropriate valuation methodology to be adopted within the new legal framework, but we have set out above the four principal questions (raising legal, valuation, and political issues) that will need to be resolved by Government in order to reform the valuation regime. We consider, in our discussion, the process by which Government may address those questions. Those questions will also be relevant to assessing the economic impact of reform.

4.26 We now turn to consider the options for a new valuation framework that would reduce premiums whilst ensuring sufficient compensation for landlords.

91 The Trustees of the Sloane Stanley Estate v Mundy [2016] UKUT 223 (LC), at [154].
Chapter 5: Possible new valuation “schemes” to reduce premiums

INTRODUCTION

5.1 In this chapter, and in Chapter 6, we explain how the valuation regime could be reformed in order to reduce premiums and to improve the enfranchisement valuation process.

5.2 We split our explanation of the options for reducing premiums into two parts: first “schemes”, and second “sub-options”. There are three alternative options for an overall “scheme” which could be adopted. Those schemes would set the general framework for the reformed enfranchisement valuation regime. We explain those three alternative schemes in this chapter.

5.3 After setting out those schemes, we then – in Chapter 6 – discuss various “sub-options” for a reformed scheme. These sub-options for reform could be incorporated within the three overall valuation schemes. Whichever “scheme” is adopted, one, some, or all of the sub-options could be adopted within it.

5.4 In Chapter 8, we draw together the schemes (from this chapter) and the sub-options (from Chapter 6) to summarise how they relate to each other and could work together. On page 22, we provide a diagram summarising the options for reform.

OVERVIEW OF THE “SCHEMES” SET OUT IN THIS CHAPTER

5.5 In this chapter, we discuss the possible overall valuation schemes that could be adopted in order to reduce premiums for leaseholders.

5.6 In the Consultation Paper, we divided the possible schemes into two categories.

(1) First, we considered two schemes (which we called Options 1A and 1B) which were based on a simple formula to calculate an enfranchisement premium, rather than being based on the market value of the asset being acquired. These schemes could result in enfranchisement premiums reducing for all leaseholders, regardless of the remaining length of their leases.

(2) Second, we considered three schemes (which we called Options 2A, 2B and 2C) which were based on taking different components from the current valuation methodology. These schemes would result in enfranchisement premiums reducing for leaseholders with 80 years or less remaining on their leases. For leaseholders with more than 80 years remaining, the schemes would not – in themselves – have any effect on enfranchisement premiums, but could do so if combined with other sub-options for reform (for example, prescribing rates at less than market value).
5.7 In this chapter, we summarise consultees’ views on those schemes and set out our conclusions about them, including the question of whether they would comply with A1P1. We conclude that:

(1) schemes based on a simple formula (namely Options 1A and 1B in the Consultation Paper) – if applied to all cases – present difficulties and would not be compliant with A1P1, and so they should not therefore be pursued.

(2) three alternative schemes based on the current valuation methodology could be pursued in order to reduce premiums. Whether these schemes would reduce the premiums for all leaseholders, or only for some of them, is dependent on which sub-options they are combined with. We refer to them as Schemes 1, 2 and 3.

(3) there is a potential role for a simple formula in a limited category of cases, but the same result could be achieved in those cases by adopting Schemes 1, 2 or 3 in combination with Sub-option (1) (that is, the prescription of rates). Nevertheless:

   (a) if a new overall scheme is introduced, based on Schemes 1, 2 or 3 together with the prescription of rates, then a simple formula could be used in a limited category of cases as the mechanism for implementing that new scheme; or

   (b) if a new overall scheme is not implemented, it would remain possible to introduce a simple formula for a limited category of leases.

5.8 Schemes 1, 2 and 3 have some similarities with Options 2A, 2B and 2C presented in the Consultation Paper, but there are significant differences. Our revised approach in Schemes 1, 2 and 3 is the result of our further consideration of valuation reform in the light of responses to our consultation. In summary, the options in the Consultation Paper were based on taking different components from the current valuation methodology and excluding others. By contrast, Schemes 1, 2 and 3 are all based on the market value of the asset, but reflecting three different assumptions. Those different assumptions have different effects on enfranchisement premiums.

5.9 The benefits of the three schemes that we set out would be different for different leaseholders:

(1) For leaseholders with 80 years or less left to run on their leases:

   (a) Schemes 1 and 2 (like Option 2A in the Consultation Paper) would reduce premiums.

   (b) Scheme 3 (like Option 2C in the Consultation Paper) would not – in itself – reduce premiums, but could do so if combined with sub-options for reform (on which see Chapter 6).

---

92 See para 6.10 below.
(2) For leaseholders with more than 80 years left to run on their leases, the three schemes (like Options 2A, 2B and 2C in the Consultation Paper) would not – in themselves – reduce premiums. Again, however, premiums could be reduced for these leaseholders if those schemes are combined with one or more of the sub-options for reform set out in Chapter 6.

SETTING PREMIUMS BY REFERENCE TO A SIMPLE FORMULA

5.10 In the Consultation Paper, we discussed the possibility of setting enfranchisement premiums by reference to a simple formula, and we considered two possible formulae. Option 1A involved setting premiums by using a multiplier of ground rent. Option 1B involved setting premiums by using a percentage of freehold value. Our preliminary view, as expressed in the Consultation Paper, was that such formulae, if of general application, would be difficult to justify under A1P1.

5.11 Those simple formulae have similarities with the valuation approach in the Scottish legislation concerning long leases, and with rentcharges legislation.

(1) The Long Leases (Scotland) Act 2012 provided for the automatic conversion of certain leasehold interests into outright ownership and the compensation payable to landlords under that Act was based on a capitalised amount of annual rent. The Act only applied to leases granted for more than 175 years, with more than 100 years left to run in respect of houses, and more than 175 years left to run otherwise. Further, the Act only applied where the annual rent was fixed and less than £100.

(2) A rentcharge is an annuity secured on some specified land. The Rentcharges Act 1977 allows the owner of land which is subject to a rentcharge to redeem it by paying an equivalent capital sum to the owner of the rentcharge. The sum payable is calculated according to a formula set out in the Rentcharges (Redemption Price) (England) Regulations 2016.

5.12 We discuss the Scottish legislation and the rentcharges formula further in paragraph 5.28 onwards below.

A multiplier of ground rent: Option 1A in the Consultation Paper

Consultees’ views

5.13 The majority view of leaseholders responding to our consultation was that enfranchisement premiums should be based on the current ground rent multiplied by 10. The views expressed by these leaseholders were strongly-held and unequivocal.

---

93 Unless the 80-year cut-off for marriage value is removed (see Sub-option 5 in Chapter 6), in which case Schemes 1, 2 and 3 would become relevant for all leaseholders, regardless of the unexpired term of their lease.

94 Enfranchisement CP, paras 15.41 to 15.57.

95 See, for example, the proposal put forward in a Private Member’s Bill by Justin Madders MP: Hansard (HC), 7 November 2017, vol 630, col 1384.

96 See further Enfranchisement CP, para 15.53 onwards.

Many leaseholders’ responses demonstrated their exasperation with the current regime, and their view that a simple formula of 10 times ground rent was an obvious and fair solution to many of the problems associated with calculating enfranchisement premiums.

“Mr Justin Madders proposal of 10 x annual ground rent as a valuation method for buying freehold is simple and fair, and should be adopted”. (David McArthur, consultee)

“I fully believe a simple formula such as 10x ground rent to buy the freehold would bring a sigh of relief to many leasehold properties as many uncapped costs would then be eradicated. Additionally freeholders would still obtain money back for their investments”. (Jason Smith, a leaseholder)

“Freehold valuations should be prescribed. That way no room for abuse or arguments. Justin Madders bill x10 ground rent is a simple formula that many will agree with”. (Malgorzata Zymla, consultee)

Some consultees suggested different multipliers.

“I propose following the multiplier used for Northern Ireland of 9 times ground rent”. (Lee Dickinson, a leaseholder)

“A simplified method for calculation of the cost of a lease extension should be as it is in Northern Ireland and Scotland, it should be 9 times the leaseholder’s starting ground rent”. (Jeanette Allen, a leaseholder)

5.14 It is clear to us that there is extensive support amongst leaseholders for the introduction of a ground rent multiplier to set enfranchisement premiums. We think that there are three main reasons for that support.

(1) First, leaseholders want a methodology that produces a lower premium for them to pay. Some leaseholders had been given quotations by their landlords of enfranchisement premiums calculated on the basis of 40 or 50 times their ground rent, and so clearly a statutory formula based on 10 times their ground rent has the potential to reduce the premium that they would otherwise have to pay significantly.

(2) Second, leaseholders want a regime that produces an easy, simple and certain calculation. The current uncertainty about the premium that they have to pay, compounded by (what they perceive to be) very high quotations from their landlords, means that they want to know where they stand.

(3) Third, some leaseholders of houses have had quotations to purchase their freehold (either at the time of purchase of the house or later) that were in fact a multiple of the ground rent. Therefore, they consider a ground rent multiplier to be a device for valuing the freehold which is already being used.

5.15 Setting premiums by using a multiplier of the current ground rent would have the potential to reduce premiums significantly in many cases, and to provide certainty for leaseholders as to what their premiums will be: see Figure 19.
The enfranchisement premium:
- for House 1 would be £500 (instead of £4,147 at present);
- for House 2 would be £500 (instead of £16,453 at present);
- for House 3 would be £3,000 (instead of £9,557 at present);
- for House 4 would be £3,000 (instead of £79,425 at present).

5.16 A ground rent multiplier would be of particular benefit to leaseholders with ground rents which are due to increase in the future (either by doubling or by reference to an index), since such ground rent income streams are generally more attractive to investors and could therefore be assessed using a lower capitalisation rate, resulting in a higher premium.

The current use of ground rent multipliers

5.17 It is apparent that leaseholders have become familiar with discussing enfranchisement premiums using the concept of a multiplier of ground rent, and that seems to be because landlords have often used ground rent multipliers when giving leaseholders a quotation for an informal lease extension or freehold purchase (that is, a voluntary lease extension or freehold acquisition, which is agreed by the landlord without the leaseholder invoking the statutory scheme). Landlords have often given leaseholders a quotation based on (say) 10, or 20, or 50 times the ground rent. The very fact that landlords sometimes use a ground rent multiplier demonstrates that, from a landlord’s point of view, in certain circumstances, a ground rent multiplier can be a legitimate and acceptable basis on which to set enfranchisement premiums.

5.18 Our understanding is that landlords who use ground rent multipliers as a basis for calculating an enfranchisement premium tend to be ground rent investors, who are interested in long leases which yield a steady, reliable, and inflation-proof, income stream. That means that they do not have any interest in (a) the reversionary value of the lease (because the current value of the reversion in, say, 250 years, is virtually nothing), or (b) marriage value (because no marriage value is payable when a lease has more than 80 years still to run). For ground rent investors, therefore, the key consideration is the ground rent during the term of the lease – that is, “the term” (see Chapter 2). Accordingly, the most important input in the current valuation methodology is the capitalisation rate, since that is used to calculate the value of the right to receive the ground rent for the duration of the lease. A ground rent multiplier will do in a direct way the same job as a capitalisation rate currently does in an indirect way: see Figure 20.

Taking House 1, a capitalisation rate of 6% gives rise to a valuation of “the term” at £1,844. (See Figure 4 above.) That calculation could, just as easily, be done by using a ground rent multiplier of 36, since £50 multiplied by 36 gives (approximately) the same premium (£1,800). For any lease of more than around 100 years, with a ground rent that is similar (in terms of amount and review structure) to that of House 1, then a valuation of “the term” based on (a) a 6% capitalisation rate or (b) a ground rent multiplier of 36 would give rise to very similar premiums.
Taking House 3, a capitalisation rate of 4% gives rise to a valuation of “the term” at £9,554. (See Figure 4 above.) That calculation could, just as easily, be done by using a ground rent multiplier of 32, since £300 multiplied by 32 gives (approximately) the same premium (£9,600). For any lease of more than around 100 years, with a ground rent that is similar (in terms of amount and review structure) to that of House 3, then a valuation of “the term” based on (a) a 4% capitalisation rate or (b) a ground rent multiplier of 32 would give rise to very similar premiums.

5.19 So, where the value of a lease to the landlord is solely in “the term”, a ground rent multiplier is currently sometimes used, and could be used, as a basis for calculating enfranchisement premiums. In order to reflect current practice, the multiplier would have to be set at a level that reflects the value of the asset in the market, rather than being based on an arbitrary figure (such as 10 times ground rent). From the point of view of a ground rent investor, the multiple that they currently use will reflect (a) the current market (just as a capitalisation rate can currently vary according to the current market), and (b) the nature of the asset (for example, a higher multiplier might be used for leases where the ground rent includes a review in line with inflation, than for a ground rent which remains static throughout the term of the lease). Adopting a multiplier, or different multipliers for different leases, would be very similar to prescribing capitalisation rates under the current method for valuing “the term”.

5.20 In summary, ground rent multipliers are currently used by landlords in the market. But they are only used to reflect the value of “the term”, and they would vary depending on the market and on the rent review provisions in the lease.

Problems with a ground rent multiplier, if used in all cases

5.21 We referred to various problems with a ground rent multiplier in the Consultation Paper, and landlords and valuers who opposed a ground rent multiplier thought that those problems were insurmountable.

5.22 If enfranchisement premiums were to be based on a ground rent multiplier in all cases, it is very unlikely that the regime would be compatible with A1P1. We do not, therefore, put it forward as an option for reform. Counsel has advised as follows:

Under this valuation method, the only factor that would be used to determine the premium is the ground rent. The ground rent figure itself may be an arbitrary amount which bears no relation to the capital value of the property. This means that the resulting premium on enfranchisement would be arbitrary. The valuation method would take no account of the reversionary value (which may be substantial) or the length of the lease. Consequently, a premium based solely on the ground rent is likely to be arbitrary, bear no relation to the value of the landlord’s asset and be too inflexible to take account of differing situations. I consider that such a valuation method is unlikely to be compatible with A1P1, and I estimate the risk of a successful challenge to such a valuation method as High. It should be disregarded.

5.23 We think that there are three main difficulties with a ground rent multiplier, if it were to apply in all cases.

5.24 First, a universal ground rent multiplier would not reflect the true value of the term.

(1) When the lease has (say) less than 100 years unexpired, the value of the term depends on the unexpired term. A premium based on 10 times ground rent would
be the same whether the lease had 10 years or 200 years unexpired, but clearly the value of the right to receive an annual ground rent for 10 years is far less than the value of the right to receive that annual ground rent for 200 years.

(2) The value of the term also depends on the rent review provisions (regardless of the length of the lease). A lease may have a ground rent of £100 per annum for the remainder of the term. Another lease with the same unexpired term may have a ground rent of £100 per annum which increases by £50 every 10 years. The landlord’s entitlement under the second lease is more valuable than under the first lease, yet a premium based on a ground rent multiplier would be the same for both leases.

5.25 Second, even if a ground rent multiplier could be used to reflect the value of “the term”, it would not reflect the value of the reversion or marriage value. Where the value of the lease to the landlord is not solely in “the term”, then a ground rent multiplier would not currently be used by landlords in the market, and would be opposed by landlords. For example:

(1) for House 1, over half of the enfranchisement premium of £4,147 is the value of the reversion, as opposed to the value of the term; and

(2) for House 2, the vast majority of the total enfranchisement premium of £16,453 comprises the value of the reversion (£7,349) and the marriage value (£7,298). The value of the term (£1,806) is relatively low.

5.26 So a multiplier of ground rent, if applied in all cases, would not be reflective of the true value of the asset to the landlord. That is because a ground rent multiplier takes no account of the length of the lease and so it does not reflect the value of the reversion or marriage value. It would therefore create unfairness to landlords.

In September 2009, leaseholders of flats in 82 Portland Place, London made a collective enfranchisement claim. 82 Portland Place is a purpose-built 1920's mansion block comprising 25 units of accommodation. The flats in the building included one used to accommodate the resident porter. Twelve of the remaining flats were held on leases which, at the valuation date, had unexpired terms of 11.8 years, and an obligation to pay ground rents of between £70 and £170 per annum. Most of the value of those flats was therefore in the reversion and the marriage value. The value of the reversion to those 12 flats based on their market value was determined as being £16.8 million. An enfranchisement premium in relation to those flats based on 10 times the ground rent would have been £15,410, which is 0.09% of the value of their reversions.

5.27 Third, as well as creating unfairness to landlords, a ground rent multiplier – if applied in all cases – would create unfairness and inconsistency as between leaseholders. The enfranchisement premium for a short lease at a peppercorn ground rent would be nothing, whereas the enfranchisement premium for a long lease at a relatively high ground rent would be high. That is the opposite result to what would be expected.

---

82 Portland Place (Freehold) Ltd v Howard de Walden Estates Ltd [2014] UKUT 0133 (LC).

We give two examples in the Enfranchisement CP, para 15.51.
Analogy with the position in Scotland and with rentcharges

5.28 We explained in paragraph 5.11 above the calculation of compensation under the Long Leases (Scotland) Act 2012 and the rentcharges formula. Both adopt a relatively simple formula, which is analogous to a ground rent multiplier. However, they both apply to interests which have no reversionary value, where the income stream being purchased is fairly low and static, and the calculation uses what can be described as “market” rates – so the difficulties set out above do not arise.

(1) As explained above, the Long Leases (Scotland) Act 2012 only applies to leases with more than 175 or 100 years left to run, and where the annual rent is fixed and less than £100. In other words, the Scottish legislation applies to leases with little or no reversionary value and with a very low annual rent, since this allows a simple formula (analogous to a ground rent multiplier) to be applied. The formula involves the ground rent being capitalised by reference to the “2.5% Consolidated Stock”, so it can be described as a market rate.

(2) Rentcharges, like the leases to which the Long Leases (Scotland) Act 2012 applies, have no reversionary value; they are a fixed income stream for a fixed period of time. Again, that allows a simple formula (analogous to a ground rent multiplier) to be applied. The formula involves the rentcharge being capitalised by reference to one of the “National Loans Fund interest rates”, so it can be described as a market rate.

5.29 Consequently, the interests being valued in the Scottish legislation and in the rentcharges legislation lend themselves to a simple formula, and the figure produced is more reflective of a market value than that produced if a multiplier of ground rent were used in all cases.

Using a simple formula for certain types of lease

5.30 We have set out above the problems that arise if a ground rent multiplier were to be used in all cases. However, as we said in the Consultation Paper, we think that there is scope for using a simple ground rent multiplier (or a multiplier based on a capitalisation rate, which could be prescribed and changed over time) in certain cases where there is no reversionary value to a lease. A scheme similar to the Scottish legislation or to the rentcharges legislation could be introduced. It could apply to leases which are similar to the leases to which those regimes apply, namely very long leases (so with little or no reversionary value) and where the ground rent is fairly low and static. But many leases in England and Wales would not fall within a scheme based on the Scottish legislation or the rentcharges legislation. That is because a wide range of leases exist in England and Wales, including those with more significant reversionary value, or with high ground rents or complex review structures. Consequently, the applicability and, therefore, the benefit of such a scheme is likely to be limited.

100 Long Leases (Scotland) Act 2012, s 47.

101 The “over 30 not over 30.5 year” National Loans Fund interest rate, published by the UK Debt Management Office.

102 Enfranchisement CP, para 15.53.
Moreover, under the current law, the calculation of the premium in respect of leases which would fall within this category (namely leases with no reversionary value and with low and static ground rent) is already relatively simple: it is the capitalised value of the ground rent. If a capitalisation rate was prescribed (see Sub-option 1 in Chapter 6) and an online calculator was provided (see Chapter 7), then Schemes 1, 2 and 3 that we put forward below could be made as accessible and as easy to apply as a ground rent multiplier or the provisions of the Long Leases (Scotland) Act 2012 and the Rentcharges Act 1977. Schemes 1, 2 and 3 would have the added benefit of being a standard universal regime, rather than being limited to particular categories of lease. Nevertheless, we set out two options for introducing a simple formula in paragraph 5.125 onwards below.

Conclusion

We acknowledge the strong support from leaseholders for the adoption of a ground rent multiplier. There are, however, problems with using a ground rent multiplier as a basis for calculating enfranchisement premiums in all cases, which we have set out above. Moreover, many of the benefits of a ground rent multiplier can be achieved by other means. First, in so far as a multiplier can legitimately be used to value “the term”, the same result can be achieved by prescribing the capitalisation rate or rates (see Sub-option 1 in Chapter 6). Second, in so far as a multiplier can provide much-needed certainty and simplicity for leaseholders, the same result can be achieved by prescribing all rates (see Sub-option 1 in Chapter 6) and by providing an online calculator (see Chapter 7). We acknowledge, however, that a key potential benefit from a multiplier of ten times ground rent favoured by so many leaseholders – namely significantly reducing enfranchisement premiums for certain leaseholders – cannot be achieved by those other means.

Crucially, a ground rent multiplier – if used in all cases – is very unlikely to be compatible with A1P1. It would not therefore provide landlords with sufficient compensation, as required by our Terms of Reference. Accordingly, we do not put forward a ground rent multiplier as an option for a new overall valuation scheme for reducing premiums. However, that is not to say that a ground rent multiplier has no potential role in a reformed valuation regime. We discuss below the potential role of a ground rent multiplier, namely (i) as a mechanism – in a limited category of cases – to implement one of the three new valuation schemes that we put forward, or (ii) (in the absence of any other reform) as a stand-alone regime for a limited category of straightforward or low-value claims.

Set percentage of freehold value: Option 1B in the Consultation Paper

Consultees’ views

The second simple formula that we suggested in the Consultation Paper was a set percentage of the freehold (FHVP) value. This suggestion received some support from consultees.

---

103 Para 5.125 onwards.
104 Enfranchisement CP, para 15.55 onwards.
"I agree that there should be a simple formula for the valuation of the freehold as a percentage i.e 10% of the value of the house". (Brenda McMahon, consultee)

"I think a simplified regime would be hugely beneficial as the domain is so complex. Perhaps it could be based on the price of properties with an exception made to areas such as London where they may be disproportionately high". (Stephen Heslop, a leaseholder)

"Personally it should be a set value compared to the value of the property: 3% cap max of the property value". (Chris Burns, a leaseholder)

Problems with a set percentage of freehold value, if used in all cases

5.35 If enfranchisement premiums were to be based on a percentage of freehold value in all cases, it would be very unlikely that the regime would be compatible with A1P1. We do not, therefore, put it forward as an option for reform. Counsel has advised as follows:

Under this valuation method, the premium would be set at a percentage of the capital value of the freehold. The premium would not reflect the length of the lease or any difference in the ground rent payable. It would therefore be equally as inflexible as a ground-rent multiplier. Depending on what percentage was set, it may result in higher premiums. I consider that such a valuation method is unlikely to be compatible with A1P1, and that the risk of a successful challenge to such a valuation method is High. It should also be disregarded.

5.36 The problems with basing enfranchisement premiums on a set percentage of the freehold value are analogous with the problems of a ground rent multiplier (see paragraph 5.21 above).

5.37 We explained above that a ground rent multiplier could, in some ways, reflect the value of “the term”, but it ignores the value of “the reversion” and marriage value. Conversely, whilst an enfranchisement premium based on freehold value might, in some ways and in some circumstances, reflect the value of the reversion, it ignores the value of the term.

5.38 Moreover, a percentage of freehold value does not reflect the true value of the reversion when the lease has (say) less than 175 years unexpired. A premium based on (say) 1% or 10% of the freehold value would be the same whether the lease had 10 years or 200 years unexpired, but clearly the value of the right to have the property back in 200 years is far less than the value of the right to have the property back in 10 years. For example, an enfranchisement premium based on 1% of the freehold value would result in an enfranchisement premium of £2,500 for both Houses 1 and 2, but:

(1) for House 1, the value of the right to get the property back in 101 years is £2,303; whereas

(2) for House 2, the value of the right to get the property back in 76 years is £7,349.

5.39 Accordingly, a set percentage of freehold value does not reflect even the value of the reversion, let alone the term and marriage value.

5.40 Finally, whilst a ground rent multiplier could eliminate disputes because the ground rent is easily ascertainable from the lease or the latest ground rent demand, the freehold
value of the property is not fixed and ascertainable: see paragraph 2.32 above. If enfranchisement premiums were based on a percentage of the freehold value, that freehold value could become significant in many cases in circumstances when it would not, under the current valuation methodology, make a significant difference to the premium.105 Using the freehold value as the basis of calculating the enfranchisement premium could therefore prompt disputes and litigation between the parties, which our three schemes seek to prevent or minimise.

Conclusion

5.41 Just as with a ground rent multiplier, there are problems with using a percentage of the freehold value as a basis for setting enfranchisement premiums in all cases, which we have set out above.

5.42 Crucially, as with a ground rent multiplier, a set percentage of freehold value – if used in all cases – is very unlikely to be compatible with A1P1. It would not therefore provide landlords with sufficient compensation, as required by our Terms of Reference. Accordingly, we do not put forward a percentage of freehold value as an option for a new overall valuation scheme for reducing premiums. However, that is not to say that a percentage of freehold value has no potential role in a reformed valuation regime. We discuss below the potential role of such a formula, namely (in the absence of any other reform) as a stand-alone regime for a limited category of straightforward or low-value claims.106

SETTING PREMIUMS BY REFERENCE TO MARKET VALUE

The Consultation Paper

5.43 In Chapter 3, we explained that enfranchisement premiums are currently assessed on the basis of the market value of the landlord’s interest, and we explained the valuation methodology that is usually adopted in order to make that assessment. There are three main components to the valuation:

(1) the term (see paragraph 2.12 onwards);

(2) the reversion (see paragraph 2.28 onwards); and

(3) marriage (or hope) value (see paragraph 2.40 onwards).

In some cases, there will be further components:

(4) additional value, such as development value (see paragraph 2.56 onwards); and/or

(5) compensation for other loss (see paragraph 2.56 onwards).

5.44 In the Consultation Paper, we discussed the possibility of setting enfranchisement premiums by taking some, and excluding other, components of the existing valuation

105 See para 7.15 below where we explain that disputes about the FHVP value of a property will often have little bearing on the enfranchise premium.

106 Para 5.135.
regime. We presented three options, and explained that those options could be combined with prescribing rates. We discuss the possibility of prescribing rates in Chapter 6 of this Report and we do not repeat that discussion here. Instead, we focus on what the overall valuation regime should be. Whichever regime is selected, prescribed rates could form part of it.

Option 2A in the Consultation Paper

5.45 Under Option 2A in the Consultation Paper (“Option 2A”), enfranchisement premiums would comprise (1) the term and (2) the reversion.

5.46 Compensation would be based on what the landlord would receive if the lease ran its course: the capitalised ground rent and the deferred freehold value. Marriage value (and hope value) would not be payable. We explain marriage value by analogy with a pair of Chinese vases in paragraph 2.41 above. Option 2A would be the equivalent of one of the Chinese vases being smashed. The holder of the other vase (the landlord) still has his or her vase, but the value of that vase has been reduced as there is no longer any additional value referable to the possibility of it being reunited with its pair.

5.47 Option 2A would also exclude any compensation for additional value, including development value.

5.48 In our worked examples in Chapter 2, Option 2A would reduce the premium for House 2, since marriage value would no longer be payable. It would not, on its own, reduce the premiums for Houses 1, 3 or 4. For those leaseholders, Option 2A would provide benefits only if combined with other reforms, such as prescribing rates.

5.49 In a collective enfranchisement claim, Option 2A would reduce the premium by removing the requirement to pay marriage value (in respect of the participating leaseholders), hope value (in respect of the non-participating leaseholders), and additional value, including development value.

Option 2B in the Consultation Paper

5.50 Under Option 2B in the Consultation Paper (“Option 2B”), enfranchisement premiums would comprise (1) the term, (2) the reversion, and (3) marriage (or hope) value where it exists.

5.51 Option 2B would therefore exclude any compensation for additional value, including development value.

5.52 In our worked examples in Chapter 2, Option 2B would not, on its own, reduce the premiums for any of Houses 1, 2, 3 or 4. For those leaseholders, Option 2B would provide benefits only if combined with other reforms, such as prescribing rates.

5.53 In a collective enfranchisement claim, Option 2B would reduce the premium by removing the requirement to pay additional value, including development value.

Option 2C in the Consultation Paper

5.54 Under Option 2C in the Consultation Paper (“Option 2C”), enfranchisement premiums could potentially comprise all of the existing components of the valuation.
5.55 In our worked examples in Chapter 2, Option 2C would not, on its own, reduce the premiums for any of Houses 1, 2, 3 or 4. Nor would Option 2C, on its own, reduce the premium in a collective enfranchisement claim. Rather, Option 2C would only provide benefits if combined with other reforms, such as prescribing rates.

Summary

5.56 Through the three Options that we presented in the Consultation Paper, we were exploring whether two significant aspects of the value of landlords' interests (under the conventional valuation methodology) should be payable.

(1) First, we were considering whether marriage value should be payable; that was the difference between Option 2A (no marriage value payable) and Option 2B (marriage value payable).

(2) Second, we were considering whether development and other additional value should be payable; that was the difference between Options 2A/2B (no development or additional value payable) and Option 2C (development and additional value payable).

Consultation responses

5.57 Unsurprisingly, leaseholders generally favoured Option 2A, since it would produce the greatest reduction in premiums, and landlords favoured Option 2C, since it would not (in itself) reduce premiums.

Fairness

5.58 Consultees raised the same arguments about the fairness or unfairness of reducing premiums as they raised in response to our other questions about valuation.

5.59 Landlords and many valuers and lawyers argued that Option 2A and (to a lesser extent) Option 2B would be unfair, and that Option 2C (that is, retaining the existing valuation methodology) was the only appropriate scheme.

“Option 2C … is the only proposed option which sufficiently compensates the landlord for their interest being acquired”. (Grosvenor, a landlord)

“Making enfranchisement cheaper “cannot be achieved simply by penalising one party to the advantage of the other”. (Wallace Partnership Group Ltd, a commercial investor)

“Ultimately the government needs to decide … if it is right to transfer asset value from one class of owner (i.e. freeholders) to another (i.e. leaseholders including buy to let landlords).” (Richard Stacey, a surveyor)

Options 2A and 2B “would be catastrophic for the industry and create overnight devaluations for landlords including pension funds, family investors and put many companies out of business”. (Trowers and Hamllins LLP, solicitors)

5.60 Some landlords provided their estimates of the effect that Options 2A and 2B would have on their income from enfranchisement premiums. John Lyon's Charity said that Option 2A would reduce their annual receipts from enfranchisement premiums by 31% (resulting in a £3.1 million reduction in their grant-making), and that Option 2B would reduce their annual receipts by 10% (resulting in a £1.1 million reduction in their grant-
making). The Church Commissioners for England said that Option 2A would reduce their annual receipts from enfranchisement premiums by 27%, or £34.75 million, and that Option 2B would reduce their annual receipts by 7%, or £9.25 million.

5.61 Conversely, leaseholders argued that Option 2A was the appropriate scheme, although as explained earlier in this chapter, the majority of leaseholders in fact favoured the scheme that we set out as Option 1A in the Consultation Paper, since that would result in an even greater reduction in premiums. A few valuers also favoured Option 2A.

5.62 We have addressed arguments about the fairness or unfairness of reducing premiums in Chapter 3 above. We do not repeat those arguments here.

Compliance with A1P1

5.63 Most landlords who objected to Options 2A and 2B referred to A1P1 and asserted, sometimes in reliance on opinions that they had commissioned from barristers, that those options would breach their human rights under A1P1. We address the compatibility of our options for reform with A1P1 below.

Marriage value

5.64 As noted above, the difference between Option 2A and Option 2B was whether marriage value was payable by the leaseholder. Some consultees commented specifically on why – as a matter of principle – marriage value should, or should not, be payable by the leaseholder.

5.65 Landlords and many valuers said that marriage value exists, and that it is “realised” by the leaseholder on enfranchisement. Taking the Chinese vase analogy (see paragraph 2.41 above), the leaseholder acquires the second vase, so has an asset that is now worth more than the two separate parts. Accordingly, they argued that it is fair that the leaseholder should pay half of that marriage value to the landlord.

“This combining of the interests creates the marriage value, and it seems fair and reasonable that this should be shared equally between the landlord(s) and the tenant.” (John Lyon’s Charity, charitable sector)

“The exclusion of such a logically necessary component of the valuation to reflect what has long been accepted as an element of the landlord’s legitimate interests, will be viewed as arbitrary and as failing to strike a fair balance.” (Cadogan, a landlord)

“The concept of marriage value is a fundamental and well-established part of the property market both for commercial and residential properties, where two or more parties with an interest in the same property are seeking to release value by the merger of their interests as part of a sale to one of the parties.” (The Portman Estate, a landlord)

5.66 Conversely, many leaseholders did not think that marriage value should be payable. As we explained in the Consultation Paper, arguably the landlord's loss is only the term and the reversion, since there is never any guarantee that marriage value will be realised; the lease might simply run its course, in which case marriage value would never be realised (by the landlord or leaseholder).
5.67 Some consultees dismissed various components of the valuation, including marriage value, as artificial constructs. The National Housing Federation, for example, argued that marriage value was “essentially speculative and intangible”.

5.68 Other consultees accepted that marriage value exists, but pointed out that it is only payable because leaseholders are “special purchasers”. No other purchaser of the freehold interest would pay marriage value, because they would not be a special purchaser.

“The price paid to the freeholder should reflect the price he would obtain if selling in the open market to an investor. That purchaser would not benefit from marriage value, which is only available to the leaseholder. It has been suggested … that as the leaseholder had a special interest in buying, marriage value should be taken into account. However if the freehold were being sold in the open market, the leaseholder would only need to pay one pound more than an investor to secure the purchase, not half of the marriage value. Therefore marriage value should be excluded. … In the analogy in paragraph 14.53 [of the Consultation Paper] the seller is selling one Chinese vase, the purchaser will therefore pay the value of one vase; if the owner of the other vase is interested he only has to outbid the next highest bidder by £1.” (Caxtons Commercial Ltd, surveyors)

“… it seems to me that the simplest way of making the cost cheaper is to stop lessees paying marriage value. I think that is justified because: (a) the freeholder cannot sell to any other party/investor and expect to receive marriage value, and (b) so far as I am aware, no other compulsory purchaser pays marriage value”. (Jennifer Ellis, a surveyor)

5.69 The options that we presented in the Consultation Paper would have seen the leaseholder either (i) paying no marriage value (under Option 2A), reflecting the position if the lease simply ran its course, or (ii) paying full marriage value (under Options 2B and 2C), reflecting the fact that the leaseholder acquires the freehold (or extended lease) and therefore realises the marriage value.

5.70 A variation on that approach was suggested by Bruce Maunder-Taylor (a surveyor), whose reasoning was similar to that of Caxtons Commercial (above).

“In my opinion, the guiding principle should be that the landlord should be compensated for damage (as with other compulsory purchase situations) and not for damage plus profit. … In reality, the hypothetical buyer for the landlord’s interest will pay hope value, and therefore that is an item of damage. 50% marriage value is an item of profit and I really do not see why the landlord should receive that.” (Bruce Maunder-Taylor, a surveyor)

5.71 Hope value is the prospect of realising marriage value in the future; a purchaser of a freehold, who is not the leaseholder, will pay hope value to reflect the fact that they might, in the future, realise marriage value by doing a deal with the leaseholder. In an enfranchisement claim, marriage value is only payable because the purchaser happens to be the leaseholder. Bruce Maunder-Taylor’s suggestion was that enfranchisement premiums should be based on what the landlord’s asset would be worth if sold in the open market to another investor. An investor would pay hope value, but not marriage value. The landlord’s loss is therefore limited to the hope value, which is what the landlord would have received from an investor. By contrast, marriage value is not “lost” by the landlord because it had never been held by the landlord; it is potential future profit. All that the landlord has lost is the opportunity to realise marriage value, and the
value of that opportunity is reflected in hope value. This suggestion falls half-way between Option 2A and Options 2B/2C, and was not an option that we discussed in the Consultation Paper.  

5.72 The reasoning expressed by Caxtons Commercial, Jennifer Ellis and Bruce Maunder-Taylor is similar. Jennifer Ellis and Caxtons Commercial did not address hope value, as Bruce Maunder-Taylor did. It seems to us that there is a key difference between whether the leaseholder’s presence in the market is ignored altogether, or ignored only at the point of valuation.

(1) If the leaseholder is assumed never to be in the market (that is, not wanting to buy the freehold or extend the lease), then no marriage value will ever be realised. It follows that no hope value would be paid by the purchaser either, because there will never be any prospect of the purchaser realising marriage value in the future by transacting with the leaseholder). Accordingly, no marriage value or hope value is ever payable.

(2) If the leaseholder is ignored at the point of valuation (that is, treated as not being in the market), then no marriage value will be realised at that point, and so marriage value is not payable. But if the leaseholder may be in the market in the future, then there is a prospect of realising marriage value in the future (by transacting with the leaseholder) and so an investor would be expected to pay hope value to reflect that prospect. Accordingly, hope value is payable.

Development value and other additional value

5.73 As noted above, the difference between Options 2A/2B and Option 2C was whether development and other additional value should be payable. Some consultees commented specifically on why – as a matter of principle – that additional value should, or should not, be payable by the leaseholder.

5.74 Landlords said that additional value (like marriage value) exists, that leaseholders acquire that additional value on enfranchisement, and that they should therefore pay for it.

"[Additional] value can be significant … There is no justification given for excluding this element of the valuation and it is difficult to think of one" (Cadogan, a landlord)

"Where this element of value exists, there is no reason why the landlord should be deprived of it or why the tenants should get something for nothing." (The Alan Mattey Group, a commercial investor)

5.75 Following Bruce Maunder-Taylor’s comment that enfranchisement premiums should reflect “damage” but not “profit”, he said:

"If there is retained property or development value, then its loss would be a matter of damage and the landlord should be paid a reasonable sum for it. But not one which reflects the potential for profit. Damage only."

---

107 We referred to the fact that an investor may pay hope value (Consultation Paper, footnote 1375), but did not present as an option an approach whereby the leaseholder pays hope value but not marriage value.
5.76 Few leaseholders commented specifically on development value, though by favouring Option 2A they clearly considered that it should not be payable. An anonymous leaseholder responding to our consultation favoured Option 2B over 2C in order to remove development value, saying that landlords should not be paid development value in circumstances when the leaseholder has to go to significant lengths in order to realise it.

“I would like to purchase the freehold of the house which contains my flat and extend my flat into the roof space, which is not currently demised … Why should my local authority freeholder be due approximately half of the development value in respect of the roof space, as I believe it could under [Option] 2C? It is an accidental owner of these spaces, which are useless on their own. It does nothing with them. The leaseholders are responsible for paying for maintenance of this space through service charges, including compensating the freeholder for managing the maintenance. This is a free lunch for the freeholder.

If the local authority freeholder released these spaces freely to leaseholders who could use them, they would quickly be made useful. This might create a windfall for the leaseholder, but it would extend and improve the housing stock. …

Consider the difference in risk and effort in developing these spaces. The leaseholder has to go through the planning process, building control, find a builder, perhaps an architect and an engineer, supervise works and budget, work around issues, and fund the whole thing, during which the property will be uninhabitable, all in their spare time. Meanwhile the freeholder is paid its half share of the expected increase in value, less the expected development costs, up front, for taking no risk and expending no effort. This is not fair.

The Chinese vases analogy used to describe marriage value is misleading in this instance. There is no equal pair coming together. Instead it is as though the freeholder holds one tea cup and the leaseholder has the other eleven”. (an anonymous leaseholder responding to our consultation)

A revised approach: from “components” to “assumptions”

5.77 As a result of our further consideration of valuation reform in the light of the responses to our consultation, we have changed the options for reform that we are suggesting to Government in this Report.

5.78 Options 2A, 2B and 2C in the Consultation Paper were all intended to yield a result that in some way was reflective of the market value of the asset. The Options were predicated on the basis that the conventional valuation methodology (see Chapter 2) would be adopted, since they were based on taking some, and excluding other, components from that conventional valuation methodology.

5.79 We now present three alternative valuation “schemes” which are not based on taking components of the conventional valuation methodology. Instead, our three schemes are based on taking the market value of the asset reflecting three different assumptions about the market in which the asset is being sold. We explain our revised approach, and our reasons for adopting it, in more detail below. But first we say something about the meaning of market value and the existing role of “assumptions” in assessing market value.
Market value and assumptions

5.80 “Market value” is defined in the International Valuation Standards 2017 as:

the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.108

5.81 The market value is an estimated amount and, within limits, there is room for differences of opinion, resulting in different valuers having different opinions of market value: see Chapters 2 and 3.

5.82 Enfranchisement premiums are not, in fact, based on a market value within the meaning of the International Valuation Standards estimate. First, “an arm’s length transaction” is one between parties who do not have a particular, or special, relationship. A landlord and leaseholder do have a particular, or special, relationship and the enfranchisement legislation reflects that by requiring the payment of marriage or hope value. Second, the valuation of enfranchisement premiums is based on assumptions, which do not exist in the market. Assumptions are useful, helpful and necessary, and can be uncontroversial: see Figure 21.

Figure 21: the role of assumptions

Various assumptions are required to be made when enfranchisement premiums are calculated. For example, there is a need to assume that the leaseholder has complied with the covenants in the lease, otherwise a leaseholder could rely on his or her own wrong in order to obtain a cheaper price. That is because if the leaseholder has let the property get into a very poor state of repair, then the current market value, and therefore the premium, would be lower. Conversely, an assumption that a property is in repair and no more109 would prevent a landlord benefiting from work carried out by the leaseholder at the leaseholder’s expense: if the leaseholder spends money on works of improvement such that the market value of the property is higher, then – without that assumption – the resultant premium would also be higher.

5.83 In the context of enfranchisement, a crucial assumption is whether the leaseholder is “in the market” – that is, that the leaseholder wants to buy the landlord’s interest or extend the lease. That assumption is crucial because the leaseholder can be expected to pay more for the freehold (or extended lease) of his or her property than anyone else would. As the owner of the leasehold interest, there are benefits to the leaseholder of acquiring the freehold (or an extended lease) which would not accrue to any other purchaser. The benefit of owning both the freehold and leasehold interest can accrue not only if the leaseholder purchases the freehold but also if the freeholder purchases the leasehold. This additional value, which arises on the coalescence of the freehold and leasehold interests is the “marriage value”. Under the current law, the landlord’s interest being acquired is valued, in the first instance, on the assumption that the

---

108 International Valuation Standards 2017 (IVS 2017), para 30, published by the International Valuation Standards Council (IVSC), an independent, not-for-profit organisation that acts as the global standard setter for valuation practice and the valuation profession. The IVSC encourages the adoption of the International Valuation Standards across the globe so as to underpin consistency, transparency and confidence in valuations worldwide.

109 Which is how we suggest that the assumption could be framed: see Sub-option 6 in Chapter 6.
leaseholder is not in the market. Where, however, the lease has 80 years or less left to run, it is then assumed that the leaseholder is in the market and the additional amount which he or she would pay (which is assumed to be half of the total marriage value) is added to the premium.

5.84 So an assumption that the leaseholder is “in the market” results in a requirement to pay marriage value. If instead the assumption is that the leaseholder is not currently in the market, but may be in the market in the future, then the result would be a requirement to pay hope value. Since the assumption is that the leaseholder is not acquiring the asset at the valuation date, marriage value will not be realised. But a purchaser of the asset who knows that the leaseholder may be in the market in the future would be expected to pay an additional amount – hope value – to reflect the possibility of selling the asset to the leaseholder in the future and, in doing so, realising marriage value.

Our revised approach

5.85 The three schemes that we now put forward reflect three different assumptions about the market in which the landlord’s interest is being valued. They are assumptions about the existence of the leaseholder, as a special purchaser, in the market.

(1) Under Scheme 1, it is assumed that the leaseholder is not in the market at the time the premium is calculated and will never be in the market.

Using the conventional valuation methodology, this assumption produces a premium based on the term and the reversion only (plus in some cases additional value and/or other loss). The value attributable to the leaseholder being in the market (marriage value and hope value) is therefore not payable.

Scheme 1 is similar in effect to Option 2A in the Consultation Paper, except that additional value may be payable (see further below).

(2) Under Scheme 2, it is assumed that the leaseholder is not in the market at the time the premium is calculated, but may be in the market in the future.

Using the conventional valuation methodology, this assumption produces a premium based on the term, the reversion, and possibly hope value (plus in some cases additional value and/or compensation for other loss). The value attributable to the leaseholder being in the market on the valuation date (marriage value) is therefore not payable.

Scheme 2 is not an option that we put forward in the Consultation Paper.

(3) Under Scheme 3, it is assumed that the leaseholder is in the market at the time the premium is calculated.

Using the conventional valuation methodology, this assumption produces a premium based on the term, the reversion, and marriage value (where it exists) (plus in some cases additional value and/or other loss).

Scheme 3 is, in effect, the same as Option 2C in the Consultation Paper.
The result produced under each option can be justified as being a “market value”, by reference to the assumed market. It is no less than a landlord could expect to receive, in that market, for his or her interest in the absence of enfranchisement legislation.

(1) Scheme 1 is what the landlord would receive if the lease ran its course and the leaseholder never chose to extend the lease or acquire the freehold.

(2) Scheme 2 is what the landlord would receive for his or her interest if sold to a third party.

(3) Scheme 3 is what the landlord would receive for his or her interest if sold to the leaseholder.

Why have we adopted the revised approach based on assumptions?

We have adopted a revised approach of setting assumptions, rather than taking components of value, for three main reasons.

First, our thinking set out in the Consultation Paper has evolved with the benefit of consultation responses. The reasons underlying the approach we were suggesting in the Consultation Paper reflected assumptions about what would happen to the lease (for example, under Option 2A, an assumption that the leaseholder would never enfranchise, and so marriage value is not payable). Another way of expressing that idea is by saying that market value is payable but making an assumption that the leaseholder is not in the market. Our approach in the Consultation Paper took the outcome from that underlying reasoning (namely, inclusion or exclusion of a given component of the valuation), without expressing the underlying reasoning. We think the more intellectually coherent approach is to base a new scheme directly on the underlying reasoning itself.

Second, we think that the more appropriate starting point for how the law should approach valuation issues is by setting assumptions, rather than by taking components of value from a particular valuation methodology. The purpose of enfranchisement premiums is to compensate landlords for their loss as a result of an enfranchisement claim. The options in the Consultation Paper were based on taking elements of that assumed loss. We think that it is more coherent for the legislation to determine the landlord’s loss by assessing what the landlord’s interest is worth in the market, and dictating what that market is, rather than by adopting different categories of loss. Moreover, we discussed the distinction between (a) the legal framework and (b) valuation methodology in Chapter 4. Deciding on the assumptions to be made when assessing market value falls within determining the legal framework (question (1) in Chapter 4: see paragraphs 4.5 to 4.6), whereas deciding on the components of value that should be paid comes closer to determining valuation methodology (question (2) in Chapter 4; see paragraphs 4.7 to 4.10).

Third, we think that options for reform that are based on these assumptions, rather than on components as we provisionally used, are less likely to be susceptible to challenge by landlords, as they would be less likely to be found to be incompatible with A1P1.\(^\text{110}\)

\(^\text{110}\) See Counsel’s Opinion in para 5.108 below, where she comments: “The risk of a Court finding that [Scheme 1] violates A1P1 would also be reduced if the option includes development or additional value (albeit that
There are differences in outcome between the use of assumptions and the use of components. For example, in contrast to Options 2A and 2B in the Consultation Paper, all three schemes that we now put forward could – in appropriate cases – include additional value (including development value). Some consultees argued that development value, where it genuinely exists, is a loss sustained by the landlord as a result of the enfranchisement claim for which he or she should be compensated. The schemes that we propose, being based on assumptions, allow such compensation to be paid. Any additional value would be assessed applying the relevant assumption and in this way the amount which might presently by payable in respect of such value could be reduced. And in any event, as explained in Chapter 6, we think that a better way to avoid leaseholders having to pay development value altogether would be by way of leaseholders electing to take a restriction on future development, thereby protecting any development value (if it exists) for the landlord.

5.91 In summary, we think that setting assumptions is a better way of providing options for reducing premiums which can truly be said to produce a “market value” and are therefore less likely to be susceptible to challenge by landlords, particularly as they would be less likely to be found to be incompatible with A1P1.

What are the consequences of our revised approach?

5.92 Schemes 1 and 3 have similarities to Options 2A and 2C in the Consultation Paper, while Scheme 2 is different.

(1) Scheme 1 is very similar to Option 2A in the Consultation Paper, save that it would include additional value, including development value.

(2) Scheme 2 was not put forward in the Consultation Paper. It is different from Option 2B in the Consultation Paper, which we do not put forward in this report.

(3) Scheme 3 is, in effect, the same as Option 2C in the Consultation Paper.

5.93 Our revised approach also has one technical consequence. We explained in paragraphs 2.11 and 2.61 that, under the current law, there are potentially different valuation methodologies that could be adopted to assess the market value of an asset. The Options in the Consultation Paper would have required the conventional valuation methodology to be adopted, and then different components from that valuation methodology would have been payable. By contrast, none of the three schemes that we now present require a particular valuation methodology to be adopted; in principle, any valuation methodology could be used to ascertain the market value of the asset, taking into account the relevant assumption. If, however, Government decides to prescribe rates for use in all cases, and if those rates are based on the conventional valuation methodology (see Sub-option 1 in Chapter 6), then Government must also require the conventional valuation methodology to be used in all cases (see paragraphs 4.9 and 4.10 above). The outcome is the same, but the route to that outcome is different. The Options in the Consultation Paper would themselves have required the conventional valuation methodology to be used in all cases. By contrast, the schemes

any such value would also be assessed on the assumption that the leaseholder was not and would never be in the market). More generally, adopting a coherent basis for the calculation of enfranchisement premiums is more likely comply with A1P1 in so far as A1P1 requires reforms to achieve their purposes in a rational and coherent way.
we now put forward do not themselves require the conventional valuation methodology to be used, but if rates are to be prescribed then the conventional valuation methodology must be used in all cases in any event.

Who would benefit from Schemes 1, 2 and 3?

5.94 Each of our three schemes could include one or more of the sub-options for reform set out in Chapter 6; for example, they could incorporate the prescription of rates. Given our Terms of Reference, our assumption is that the combination of whichever scheme and sub-option(s) Government decides to adopt, the effect will be that the overall premium to be paid by leaseholders will be reduced. The choice of scheme, and the sub-options within it, will determine the extent of the reduction in price.

5.95 Schemes 1 and 2 provide a direct reduction in premiums for leaseholders with 80 years or less left to run on their leases. It is therefore important to emphasise that:

1. Schemes 1 and 2 (like Option 2A in the Consultation Paper) will not, by themselves, reduce premiums for leaseholders with more than 80 years remaining. That is because the 80-year cut-off for marriage value already means that marriage value and hope value would not be payable by these leaseholders (see further Sub-option 5 in Chapter 6). To reduce the price for those leaseholders, Schemes 1 and 2 would need to be combined with one or more of the additional reforms in Chapter 6 which would have that effect.

2. Scheme 3 (like Option 2C in the Consultation Paper) will not, by itself, reduce premiums for any leaseholders. To reduce the price payable it would need to be combined with one or more of the additional reforms in Chapter 6 which would have that effect.

5.96 For example, any of Schemes 1 to 3 would reduce the price paid by all leaseholders if they were combined with the prescription of rates at below-market value.

5.97 For leaseholders with 80 years or less left to run under their leases, Scheme 1 would produce the greatest reduction in premiums, since marriage value would not be payable. Scheme 2 would produce the second biggest reduction in premiums, since hope value instead of marriage value would be payable, and hope value is always less than marriage value. Scheme 3 would not, without more, make any difference to the premium payable.

5.98 Taking our worked examples from Chapter 2:

1. Schemes 1 and 2 would directly reduce the premium payable for House 2: see Figure 22 below. Schemes 1 and 2 would not, in themselves, have any effect on the premium payable for Houses 1, 3 or 4. Schemes 1 and 2 would only reduce premiums for those houses if combined with other reforms from Chapter 6.

2. Scheme 3 would not, in itself, have any effect on the premium payable for any of Houses 1 to 4. Scheme 3 would only reduce premiums for those houses if combined with other reforms.
Figure 22: effect of Schemes 1, 2 and 3 on the enfranchisement premium for House 2 (ignoring the effect of further sub-options for reform in Chapter 6)

| House 2 |
|------------------|------------------|------------------|------------------|
| **Details of existing lease** |
| Unexpired term | 76 years |
| Ground rent | £50 pa rising to £200 pa |
| FHVP value | £250,000 |

| **Enfranchisement premiums** |
|------------------|------------------|------------------|------------------|
| Valuation under: | Current law | Scheme 1 | Scheme 2 | Scheme 3 |
| Part (1): term | £1,806 | £1,806 | £1,806 | £1,806 |
| Part (2): reversion | £7,349 | £7,349 | £7,349 | £7,349 |
| Part (3): marriage / hope value | £7,298 (marriage value) | £0 (no marriage value) | £1,460 (hope value) | £7,298 (marriage value) |
| **Total premium** | £16,453 | £9,155 | £10,615 | £16,453 |

5.99 Having explained the change of approach from the Consultation Paper, we now turn to explain the three schemes that we put forward in more detail.

**Scheme 1: assumption that the leaseholder is not in the market and will never be in the market**

5.100 If it is assumed that the leaseholder is not in the market and will never be in the market, then the “market” value for the landlord’s interest is simply the value of the term and reversion (plus, where it exists, additional value and/or other loss). If the lease ran its course and the leaseholder never chose to extend it or acquire the freehold, the landlord would get nothing more than the ground rent throughout the term of the lease and vacant possession upon its expiry – that is, the value of the term and reversion. This assumption would, therefore, mirror that scenario and mean that the landlord would not receive marriage value or anything in respect of the hope of receiving marriage value in the future (hope value). The outcome of Scheme 1 is similar to that suggested in Option 2A in the Consultation Paper. It also reflects the basis of valuation (but not the methodology adopted) under the original enfranchisement legislation: as we go on to

111 Assuming that hope value is assessed at 10% of marriage value.
112 These calculations do not take into account any other reforms which, combined with Schemes 1, 2 or 3, would reduce the premium.
discuss in Chapter 9, premiums under the original valuation basis do not include marriage value since it is assumed that the leaseholder is not in the market.

5.101 The leaseholder is a “special purchaser”, because by acquiring the freehold, the leaseholder stands to realise marriage value. Marriage value would not be realised by any other person who purchases the freehold. The effect of the assumption in Scheme 1 is that the leaseholder, as a “special purchaser”, is ignored. Of course, by definition, the valuation is only being done because the leaseholder is enfranchising. Landlords would therefore argue that the leaseholder should be included as a special purchaser because that is what is in fact happening. The leaseholder is acquiring an asset that is worth more than the sum of its parts, and should at least share the benefits of doing so with the landlord. On the other hand, leaseholders would argue that the fact that their need to make an enfranchisement claim is borne out of the limited and wasting nature of the asset that they hold means that it is unfair for the landlord to be able to make a profit out of selling his or her interest to the leaseholder rather than to a third party. A landlord should receive the value of his or her asset in the eyes of a third party, and not a profit made as a result of the leaseholder’s willingness to outbid the third party in order not to lose his or her entitlement to possession of the property.

Figure 23: Potential analogy with compulsory purchase

Many consultees – in particular landlords and valuers – referred to enfranchisement as a form of compulsory purchase. If it is analogous, then an assumption that the leaseholder is never in the market would most closely fit with the compulsory purchase regime. It is a principle of compulsory acquisition that any increase or decrease in the value of the land acquired, which is attributable solely to the scheme under which the particular land is acquired, is to be disregarded in the assessment of open market value for the purposes of compensation. This principle is known as the Pointe Gourde principle.113 The current enfranchisement valuation methodology partially reflects the Pointe Gourde principle by including a “no-Act” assumption. But the enfranchisement regime does not reflect the Pointe Gourde principle in relation to the identity of the purchaser; in fact, it does the opposite. Enfranchisement premiums are valued on the basis that the special purchaser (the leaseholder) is acquiring the interest. By contrast, in compulsory purchase law, the Pointe Gourde principle requires the valuation to be conducted on the basis that the special purchaser (the authority acquiring the land) is ignored. Accordingly, the assumption in Scheme 1 that the leaseholder is not in the market could be viewed as simply an extension of the Pointe Gourde principle.

There is, however, an argument that, despite the compulsory nature of the transaction, enfranchisement claims are not properly analogous with compulsory purchase orders. We discuss the competing views about the analogy with compulsory purchase in paragraphs 3.70 and 3.88 to 3.90 above.

- Landlords are aware of the market necessity of either lease extensions or freehold acquisitions when either granting or purchasing reversionary interests. In fact, the prospect of an enfranchisement claim being made, and the payment of a premium for any extension or transfer, is often a significant attraction for investors in leasehold reversions. So landlords know that enfranchisement is necessary, and many welcome the income that an enfranchisement claim provides.

---

113 It is derived from the decision in Pointe Gourde Quarrying and Transport Co v Sub-Intendent of Crown Lands [1947] AC 565.
- Enfranchisement is not a free choice exercised by the leaseholders. Leaseholders come under pressure to enfranchise, as the alternative is that the lease runs out and the leaseholder is left without their home or any financial asset. When the commercial necessity of enfranchisement is properly considered, the analogy with compulsory purchase orders – the prospect of which do not loom over ordinary properties in a comparable fashion – is not as convincing as is sometimes supposed.

If it is accepted that enfranchisement and compulsory purchase are not analogous, then the analogy with the Pointe Gourde principle falls away, and the question of whether the leaseholder, as a special purchaser, should be included or excluded must be decided on its own.

5.102 There are competing arguments as to whether the leaseholder, as special purchaser, should be ignored. Landlords would say that enfranchisement is common and the necessity to enfranchise ought to be well-known to leaseholders, so it is acceptable for their presence in the market (and therefore the payment of marriage value) to be taken into account. On the other hand, leaseholders would say that the very fact that enfranchisement is necessary and common provides even more support for a regime under which only the landlord’s loss, rather than the landlord’s profit, is to be paid. Leaseholders are, in effect, being penalised for enfranchising; they are forced to enfranchise because their lease is running down, but at the same time they have to pay more than any other person would have to pay for the freehold. Leaseholders would also say that Scheme 1 still produces a market value because there is no guarantee that a leaseholder will ever enfranchise – the lease might just run its course.

5.103 The assumption in Scheme 1:

1. would reduce premiums where the current lease has 80 years or less left to run and the leaseholder seeks:
   a. to extend it;
   b. (if a house, falling outside the original valuation basis) to purchase the freehold individually; or
   c. (if a flat) to participate in a collective enfranchisement.

2. would reduce premiums on a collective enfranchisement, where the leases of any of the non-participating leaseholders have 80 years or less left to run and the participating leaseholders need to pay hope value in respect of them.

3. would (on its own) have no effect on premiums where the current lease has more than 80 years left to run, since marriage value is not payable in any event by reason of the 80-year cut-off (see further paragraph 6.210 onwards below), but Scheme 1 could be used to reduce premiums for these leaseholders if combined with other reforms from Chapter 6.
Benefits of Scheme 1

Provides compensation to landlords based on a market value of their interest.

Directly reduces premiums for leaseholders with 80 years or less left to run. These leaseholders would no longer have to pay marriage value.

If combined with other reforms (from Chapter 6), could be used to reduce premiums for all leaseholders.

Who would benefit?

Scheme 1 would only directly benefit leaseholders with 80 years or less left to run.

But all leaseholders could benefit if Scheme 1 is combined with other reforms to reduce premiums.

Development value and other additional value

5.104 Scheme 1 is based on making an assumption rather than explicitly excluding certain elements of value. On this revised basis, the scheme would include development or other additional value. We explained in paragraph 5.90 above why we think that additional value should be included, in particular because its inclusion within Scheme 1 means that the scheme is less likely to be susceptible to challenge by landlords for being incompatible with A1P1. We also explained that there was an alternative way in which leaseholders could avoid having to pay development value: see Sub-option 3 in Chapter 6.

5.105 Importantly, under Scheme 1, any additional value would be assessed on the same assumption that the leaseholder was not and would never be in the market. That could reduce the amount that is currently payable in respect of such value.

5.106 Take, as an example, a freehold interest which includes a basement, and assume that the basement could be developed either by incorporating it into the existing ground floor flat or by creating a separate lower ground floor flat. If there was an assumption that the ground floor leaseholder was not in the market and would never be in the market, then any development value which could only be realised by granting a lease of the basement to the leaseholder could not be taken into account. However, development value which could be realised by independently developing the basement could be. This value would not therefore be the value of the development to the leaseholders as the owners of the freehold post-enfranchisement (as they are assumed not to be in the market), but the value of the development in the hands of the current freeholder. In other words, the value would be calculated by reference to what a hypothetical purchaser of the freehold interest would pay the current freeholder, in addition to the value of the term and reversion, for the potential to develop the basement in the future.

5.107 In this example, the freeholder would be paid something on enfranchisement in respect of development value, even though this sum might be less than would be paid in respect of development value at present. However, where the only means of realising development value is through a deal with one or more leaseholders, the basis of valuation under Scheme 1 would not provide the landlord with any compensation in
respect of that potential development value. For example, where a roof void could be developed, but only by incorporating it into a top floor flat because that would be the only means of access, the landlord would not receive any compensation in respect of what he or she might otherwise have been paid by the top floor leaseholder to acquire the roof void.

Compatibility with A1P1 of enfranchisement premiums based on Scheme 1

5.108 Counsel has provided the following advice on the compatibility of Scheme 1 with A1P1:

In my view, the question of whether this option is compatible with A1P1 is fairly finely balanced. Marriage value comprises the additional value an interest in land gains when the landlord’s and the leaseholder’s separate interests are ‘married’ into single ownership. The aggregate value of those two interests held separately is often significantly less than the value of both where both are held by the same person. The analogy often used is that of a pair of Chinese vases: the vases are worth more as a pair than the sum of their individual values if owned separately. The additional value, where they are owned as a pair, is equivalent to marriage value. Marriage value can make a significant difference to the premium payable, as evident from the calculations in Figures 14 and 15 of the Consultation Paper. The shorter the lease (below the 80-year cut-off), the greater will be the marriage value. The effect of this scheme will therefore be to deprive landlords of a significant portion of what they otherwise would have received where a leaseholder acquires the freehold or extends the lease. Therefore, this scheme does not reflect the true market value where the leaseholder is in the market.

On the other hand, although the leaseholder under this scenario will gain the enhanced value from marrying the freehold and leasehold interests, arguably, the landlord loses nothing under this scenario. The value payable to the landlord reflects the minimum that a third-party investor would pay the landlord to purchase his or her interest (without any hope that the leaseholder would acquire the freehold or extend the lease in future). It is the equivalent of smashing the leaseholder’s vase, so far as the landlord is concerned: the landlord still holds his or her vase, but there is no additional value referable to the possibility of it being reunited with its pair. It is, in this sense, still a ‘market value’, just a market in which a special purchaser (i.e. the leaseholder) does not exist and the lease simply runs its course.

Ultimately, this issue is unlikely to turn on semantics as to whether this option results in a premium that reflects ‘market value’; on any view, the landlord will be deprived of at least part of the premium that otherwise would have been paid by the enfranchising leaseholder. The question will ultimately turn on whether the UK or Strasbourg Courts would regard this reduction in compensation as upsetting the fair balance between landlords’ interests and those of general society, and whether it will result in landlords shouldering an excessive burden. This will ultimately depend on the strength of the public interest or interests at stake. If the aim of the legislation is the wholesale reform of UK property laws affecting leasehold enfranchisement, and deliberate re-distribution of wealth from one part of society to another, then the Courts are likely to be more willing to conclude that the legislation strikes a fair balance, despite the reduction in compensation. It would be possible to distinguish between legislation based on this option, and the impugned measure in Lindheim, under which the compensation payable
to lessors bore little relation to any form of market value and where the compulsory lease extension was for an indefinite duration.

I can also see that there would be strong practical reasons for adopting this scheme. Calculation of marriage value is complex and controversial. If marriage value were no longer payable, the need to calculate relativity (or a deduction for Act rights) would fall away. This would also have the knock-on effect of reducing professional fees.

The risk of a Court finding that this option violates A1P1 would also be reduced if the option includes development or additional value (albeit that any such value would also be assessed on the assumption that the leaseholder was not and would never be in the market). The example provided by the Law Commission in its written instructions to me is that of a freehold interest which includes a basement, which could be developed by incorporating it into an existing ground floor flat or by creating a separate lower ground floor flat. If there was an assumption that the ground floor leaseholder was not and would never be in the market, then any development value which could only be realised by granting a lease of the basement to the leaseholder could not be taken into account, but development value which could be realised by independently developing the basement could be. This value would be calculated by reference to what a hypothetical third-party purchaser of the freehold interest would pay the current freeholder, in addition to the value of the term and reversion, for the potential to develop the basement in the future. In this example, the freeholder would receive something on enfranchisement in respect of development value, even though this might be less than would be paid at present.

Without knowing the final shape of legislation based on this option, it is difficult to advise on prospects of a successful A1P1 challenge. However, if the aim of the legislation is the wholesale reform of UK property laws affecting leasehold enfranchisement and the option were to include development or additional value, then on balance, I consider that it is marginally more likely than not that the option would be compliant with A1P1. In other words, the risk of a successful A1P1 challenge to this option is slightly less than 50% i.e. towards the upper end of Medium Low.

**Option 1.**

5.109 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is not in the market and will never be in the market (which we call “Scheme 1”). The scheme would reduce premiums for leaseholders with 80 years or less left to run by removing the requirement to pay marriage value. Scheme 1 could also reduce premiums for leaseholders of any lease length, if combined with other reforms outlined in Chapter 6 of this Report.

**Scheme 2: assumption that the leaseholder is not in the market, but may be in the market in the future**

5.110 If it is assumed that the leaseholder is not in the market, but may be in the market in the future, then the “market” value for the landlord’s interest is the value of the term and
reversion, plus potentially an amount to reflect the hope of doing a deal with the leaseholder in the future. This is what the landlord would get in the open market, if the landlord’s interest were sold to an investor as opposed to the leaseholder. As the investor would not be a special purchaser, no marriage value would be realised on the sale to the investor. However, the investor would anticipate the possibility of releasing marriage value, by a sale to the leaseholder, in the future, and may pay something in addition to the value of the term and reversion to reflect the hope of this happening. If there were a significant number of years left on the lease, then the investor is likely to pay little, if anything, in respect of hope value. However, if the lease is very short, then the amount of hope value might be significant. This reflects the general position in respect of marriage value: the shorter the term, the greater the marriage value. However, hope value is always and logically less than marriage value. That is because marriage value reflects the fact that the leaseholder is in the market and is actually purchasing. In contrast, hope value assumes that there is only a possibility of the leaseholder purchasing. The marriage value that would be released has to be discounted to reflect the risk that the leaseholder may never purchase, or may not do so for some time. To adopt an old adage, hope value is worth less than marriage value because a bird in the hand is worth two in the bush.

5.111 Scheme 2 reflects the argument made by consultees: see paragraph 5.64 above. Under Scheme 1, the existence of the leaseholder as a special purchaser is ignored altogether. Under Scheme 2, by contrast, the existence of the leaseholder as a special purchaser is not ignored altogether. Rather, the possibility of doing a deal with the leaseholder in the future, and thereby realising marriage value, is taken into account by requiring the payment of hope value.

5.112 It might be argued that intellectually Scheme 2 sits uncomfortably between Scheme 1 and Scheme 3. Under Scheme 1, the leaseholder as special purchaser is ignored altogether, so no marriage value is payable. Under Scheme 3, the leaseholder is taken into account as the purchaser (since by definition the leaseholder is the purchaser), so marriage value is payable. Under Scheme 2, the leaseholder is partially ignored, which reflects neither a complete disregard of the special purchaser nor the reality that the leaseholder is the purchaser. So, if marriage value is not payable (because the leaseholder as special purchaser is to be ignored), then nor should hope value be payable either; that is because hope value is parasitic on marriage value (since it reflects the value of the prospect of realising marriage value in the future). If there is no marriage value to be realised, nor should there be any payment of hope value.

5.113 Nevertheless, it seems clear to us that (as with Scheme 1) Scheme 2 produces a market value: it is the market value which would be paid by an investor.

5.114 If Scheme 2 were pursued, and rates were prescribed, then not only would relativity (or a no-Act deduction) need to be prescribed in order to work out the marriage value, but the discount to apply to the marriage value to arrive at the hope value for any given lease length would also need to be prescribed. However, these two elements could be combined to produce a prescribed relativity which incorporates the discount, so that when applied in one step, it produces a value which reflects hope, rather than marriage, value.
5.115 The assumption in Scheme 2:

(1) (similarly to Scheme 1) would reduce premiums where the current lease has 80 years or less left to run and the leaseholder seeks:

(a) to extend it;

(b) (if a house, falling outside the original valuation basis) to purchase the freehold individually; or

(c) (if a flat) to participate in a collective enfranchisement.

It would not reduce the premium in these cases to the same extent as Scheme 1 above.

(2) would have no effect on the premium payable on a collective enfranchisement in respect of leases of any of the non-participating leaseholders that have 80 years or less left to run. That is because, at present, the participating leaseholders need to pay hope value in respect of those leases, and under Scheme 2 hope value will continue to be payable in respect of these leases.

(3) (similarly to Scheme 1) would (on its own) have no effect on premiums where the current lease has more than 80 years left to run, since hope value is not payable in any event by reason of the 80-year cut-off (see further paragraph 6.210 onwards below), but Scheme 2 could be used to reduce premiums for these leaseholders if combined with other reforms from Chapter 6.

5.116 Whilst Scheme 2 was not put forward in the Consultation Paper, it represents a compromise between the two most popular options: Option 2A, which was favoured by leaseholders as being the option which would produce the lowest premiums, and Option 2C which was favoured by landlords and professionals as producing the highest premiums and being most similar to the current regime. Further, when considering options based on an assumption as to whether or not the leaseholder is in the market, this option logically falls to be considered.

<table>
<thead>
<tr>
<th>Benefits of Scheme 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides compensation to landlords based on a market value of their interest.</td>
</tr>
<tr>
<td>Directly reduces premiums for leaseholders with 80 years or less left to run (but not by as much as Scheme 1). These leaseholders would pay hope value instead of marriage value.</td>
</tr>
<tr>
<td>If combined with other reforms (from Chapter 6), could be used to reduce premiums for all leaseholders.</td>
</tr>
</tbody>
</table>

**Who would benefit?**

Scheme 2 would only directly benefit leaseholders with 80 years or less left to run.

But all leaseholders could benefit if Scheme 2 is combined with other reforms to reduce premiums.
Development value and other additional value

5.117 As with Scheme 1 above, Scheme 2 could also include development or other additional value: see paragraphs 5.104 above. Such value would be assessed on the assumption that the leaseholder was not in the market, but may be in the market in the future. In the examples given above of development value in a basement and roof void, which could be released by deals with the leaseholders, this development value would be calculated by reference to what an investor would pay the landlord for the prospect of doing a deal with the leaseholder in the future. This would be less than the development value in the hands of that leaseholder, as a discount would need to be applied to reflect the risk that the leaseholder may never seek to do a deal, or may not do so for some time. In other words, this is another form of hope value.

Compatibility with A1P1 of enfranchisement premiums based on Scheme 2

5.118 Counsel has provided the following advice on the compatibility of Scheme 2 with A1P1:

If it is assumed that the leaseholder is not in the market, but may be in the market in the future, then the ‘market value’ of the landlord’s interest is the value of the term and reversion, plus potentially an amount to reflect the hope of doing a deal with the leaseholder in the future. This is what the landlord would receive in the open market, if the landlord’s interest was sold to an investor as opposed to the leaseholder. As the investor would not be a special purchaser, no marriage value would be realised on the sale to the investor. However, the investor would anticipate the possibility of releasing marriage value by a sale to the leaseholder in the future, and may pay something in addition to the value of the term and reversion to reflect the hope of this happening. This scheme would reduce premiums where the current lease has less than 80 years unexpired, but not to the same extent as in Scheme 1 above. Further, it would not reduce the premium on a collective enfranchisement in so far as it relates to the leases of any non-participating leaseholders who have less than 80 years left to run because hope value is already payable in respect of such leases (see para 14.69 of the Consultation Paper). According to the Law Commission, this scheme therefore produces a ‘market value’; it is the market value which would be paid by an investor.

I consider that it is more likely than not that this option is compatible with A1P1, although it remains reasonably finely balanced. The risk of a successful A1P1 challenge is lower than it would be for Scheme 1 because the premium payable is closer to the amount that the landlord would receive if the leaseholder was in the market, and is therefore closer to the true ‘market value’ in the circumstances of leaseholder enfranchisement. Again, the risk of a Court finding that this option violates A1P1 would also be reduced if the option includes development or additional value. In this scenario, the development value would be calculated by reference to what an investor would pay the landlord for the prospect of doing a deal with the leaseholder in the future (which would be less than the development value in the hands of that leaseholder, as a discount would need to be applied to reflect the risk that the leaseholder may never seek to do a deal). On balance, I consider that the risk of a successful A1P1 challenge under this option is Medium Low.
Option 2.

5.119 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is not in the market but may be in the market in the future (which we call “Scheme 2”). The scheme would reduce premiums for leaseholders with 80 years or less left to run by removing the requirement to pay marriage value and replacing it with a requirement to pay hope value (which is less than marriage value). Scheme 2 could also reduce premiums for leaseholders of any lease length, if combined with other reforms outlined in Chapter 6 of this Report.

Scheme 3: assumption that the leaseholder is always in the market

5.120 The assumption that the leaseholder is in the market leads to a premium which includes the value of the term and reversion and marriage value, where it exists, plus additional value, including development value. This scheme is the same as that put forward as Option 2C in the Consultation Paper, and reflects the current valuation methodology. This option would not, in itself, reduce the premiums payable by any leaseholders. It is an option for Government to reduce premiums only if combined by other reforms; for example, prescribing rates at less than market value.

Benefits of Scheme 3

Provides compensation to landlords based on a market value of their interest.

If combined with other reforms (from Chapter 6), could be used to reduce premiums for all leaseholders.

Who would benefit?

Scheme 3 would not benefit any leaseholders directly.

But all leaseholders could benefit if Scheme 3 is combined with other reforms (from Chapter 6) to reduce premiums.

Development value and other additional value

5.121 As with Schemes 1 and 2 above, Scheme 3 could also include development or other additional value: see paragraphs 5.104 and 5.117 above. Such value would be assessed on the assumption that the leaseholder was in the market. In the examples given above of development value in a basement and roof void, which could be released by deals with the leaseholders, the amount payable to the landlord in respect of development value would be calculated by reference to what the leaseholders would pay the landlord for the ability to develop the basement or roof void. Once the freehold is acquired, the leaseholders have that value, which is a form of marriage value, regardless of whether they choose to realise it by developing. Consequently, the amount payable in respect of development value under Scheme 3 will always be higher than it would be under Scheme 2, as there is no need to discount the value to reflect the fact that the leaseholder(s) may never choose to realise it.
Compatibility with A1P1 of enfranchisement premiums based on Scheme 3

5.122 Counsel has provided the following advice on the compatibility of Scheme 3 with A1P1:

The assumption that the leaseholder is always in the market leads to a premium which includes the value of the term and reversion, as well as marriage value, where it exists. Applying this assumption to development and other additional value means that value in the hands of the leaseholder can be considered, whether or not he or she chooses to realise it. This scheme, on its own, would not reduce premiums for leaseholders. As a result, this scheme is highly likely to be compatible with A1P1 as it most closely resembles the current valuation methodology. The risk of a successful challenge to this valuation method is Low.

Option 3.

5.123 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is always in the market (which we call “Scheme 3”). The scheme would only have the effect of reducing premiums if combined with other reforms outlined in Chapter 6 of this Report.

Option 4.

5.124 As well as selecting Scheme 1, 2 or 3 as an overall valuation regime, if Government wishes to prescribe rates (see Option 7 below, which we call “Sub-option 1”) and introduce an online calculator (see Option 14 below), it must also require the conventional valuation methodology (and no other alternative methodology) to be used for the valuation of enfranchisement premiums under that Scheme.

The potential role of a simple formula

5.125 In this chapter, we have discussed options for a new overall scheme for the calculation of enfranchisement premiums. In paragraph 5.10 onwards above, we discussed three examples of simple formulae:

(1) a capitalised ground rent (similar to the Scottish legislation and rentcharges legislation);116

(2) a ground rent multiplier (Option 1A in the Consultation Paper), which has some similarities with a capitalised ground rent,117 and

114 Para 6.115.
115 Paras 7.36 to 7.37.
116 Paras 5.11 and 5.28.
117 Para 5.13 onwards.
We explained why a simple formula could not be used in all cases as a basis for calculating enfranchisement premiums. But we also said that a simple formula could have a potential role in a limited category of cases. We now explain what that role could be.

A simple formula as a mechanism for implementing Schemes 1, 2 or 3

5.126 We have set out three alternative overall schemes, all of which are based on an assessment of market value, which could be implemented on their own or in combination with one or more of the sub-options in chapter 6, in order to reduce premiums.

5.127 If Government decides to implement one of Schemes 1, 2 or 3, combined with the prescription of rates (Sub-option 1 in Chapter 6), then different mechanisms could be used in order to implement that reform.

5.128 Each of Schemes 1, 2 or 3 is based on a particular assumption as to whether the leaseholder is in the market. The simplest and most direct means of implementing that reform would be by adopting the necessary assumption in legislation combined with the creation of the process for setting the prescribed rates to be used in the valuation.

5.129 But it would be possible, for certain categories of lease, to achieve the same result by using a simple formula as the mechanism.

(1) A ground rent multiplier:

(a) The value of “the term” is calculated based on the ground rent and a capitalisation rate.

(b) If the value of the lease is solely in “the term” (that is, there is no value in the reversion and there is no marriage value – because it is a very long lease), and if the ground rent is static, then the premium could be calculated based on a ground rent multiplier. That is because, for very long leases with a static ground rent, a ground rent multiplier would give the same premium as a prescribed capitalisation rate (if they were set at an equivalent level): see 5.18 and Figure 20 above.

(c) In substance, in relation to that particular category of leases, there would be no difference in outcome as between the use of a ground rent multiplier

---

118 Para 5.34 onwards.

119 And also to require the conventional valuation methodology to be used in all cases (see Option 4 above; para 5.124).

120 It would be necessary to establish what that multiplier should be, and the multiplier could be decided in the same way that a prescribed capitalisation could be decided. The use of a multiplier is more likely to be compatible with A1P1 if it is based on a capitalisation rate which is itself linked to the market value of the asset. By contrast, selecting a multiplier without any basis for doing so is less likely to be compatible with A1P1.
and the overall valuation scheme (with the prescription of rates) that we suggest above.

(2) A capitalised ground rent:

(a) The same principles would apply to a capitalised ground rent, based on the Scottish legislation. For a particular category of leases, there would be no difference in outcome as between the use of a capitalised ground rent and the overall valuation scheme (with the prescription of rates) that we suggest above.

5.130 A percentage of market value cannot feasibly be used as a mechanism to produce the same premium as would be payable under Schemes 1, 2 and 3 with prescribed rates, and so we do not put it forward as an option in this respect.

5.131 We acknowledge that there was significant support from leaseholders for a simple formula, and many consultees queried why the Scottish model could not simply be adopted in England and Wales. In our view, an equivalent model could be introduced in England and Wales. But as we explained in paragraphs 5.30 and 5.31 above, such a regime could only be applied to a limited category of leases, as its universal application is very likely to be incompatible with A1P1. Nevertheless, if desired, those categories of case that are suitable for a simple formula (namely a capitalised ground rent, or a ground rent multiplier) could be singled out to be dealt with by that mechanism, with the remaining cases been dealt with under the overall scheme that is selected.

5.132 For the category of leases that are singled out for that mechanism, the outcome would be the same as under the overall scheme; the difference would simply be the mechanisms that are used to calculate the premium. This approach would introduce complexity and potential confusion by creating different valuation mechanisms for different types of lease, all of which ultimately achieve the same result. We therefore consider that the implementation of a single scheme would be preferable, but using different mechanisms to implement that scheme is an option for Government.

<table>
<thead>
<tr>
<th>Benefits of a simple formula as a mechanism for implementing (in part) Schemes 1, 2 or 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simple formula supported by leaseholders.</td>
</tr>
<tr>
<td>Easy to understand (in those cases to which it would apply).</td>
</tr>
<tr>
<td>Who would benefit?</td>
</tr>
<tr>
<td>Leaseholders whose leases fall within the limited category to which the simple formula would apply.</td>
</tr>
</tbody>
</table>
Option 5.

5.133 As a mechanism to implement Schemes 1, 2 or 3 as a new overall valuation regime, particular categories of leases could be identified for which enfranchisement premiums could be calculated by using a ground rent multiplier or a capitalised ground rent.

5.134 But such an approach would introduce complexity and potential confusion by creating different valuation mechanisms for different types of lease, all of which ultimately achieve the same result.

A simple formula as a stand-alone regime for straightforward or low value claims

5.135 If the existing valuation regime is retained (and so none of the new overall valuation schemes in this chapter, and none of the sub-options for reform from Chapter 6, are implemented), it would remain possible for a simple formula to be introduced for a limited category of appropriate leases. For example, a simple formula, which is broadly equivalent to the Scottish regime, could be used for leases which are similar to those to which the Scottish legislation applies – namely leases with a long unexpired term, and a low or static ground rent: see paragraphs 5.28 and 5.131 above.

5.136 The majority of consultees who responded to our consultation question asking whether a separate regime ought to be created for low value or straightforward cases were in favour of such a scheme. Further, there was a great deal of consensus that such cases are those where there is little reversionary value and/or the ground rent is low and fairly static. However, there was very little consensus as to how these cases could be identified.

5.137 A separate scheme for low value cases is likely to benefit only a minority of leaseholders. And as we explained in paragraph 5.31 onwards above, if Schemes 1, 2 or 3 are introduced, if rates are prescribed, and if an online calculator is introduced, then we take the view that there would be little need for a separate regime for low value or straightforward cases: the calculator would, in effect, identify these straightforward cases and the valuation would be simple at the point of use. For example, the online calculator would recognise that the lease is one in which there is no reversionary value (because it is long), and produce a premium based on the ground rent.

5.138 If, however, Government rejects wholesale reform, then the creation of a separate regime for a particular category of leases is a remaining option for more limited reform. Such a regime could be based on a capitalised ground rent (similar to the Scottish regime and the rentcharges formula), a ground rent multiplier, or a percentage of freehold value.

---

121 Enfranchisement CP, para 15.29.

122 We explained in para 5.130 above that a percentage of freehold value could not be used as a mechanism to implement Schemes 1, 2 or 3. But in this different context of devising a stand-alone regime for straightforward or low value claims (in the absence of other reforms), it is possible that a limited category of leases could be identified for which a formula based on a percentage of freehold value could be appropriate.
Benefits of a standalone regime for low value or straightforward cases

If Government rejects the options for reform in this Report and concludes that the general valuation regime cannot be made simpler and more certain, then there would be scope to carve out a limited category of relatively simple and low-value claims which could be subject to a simple regime.

Who would benefit?

Leaseholders whose leases fall within the limited category to which the simplified regime applies.

Option 6.

5.139 If the existing valuation regime is maintained, Government could nevertheless create a simple formula – such as a ground rent multiplier, a capitalised ground rent, or a percentage of freehold value – that would apply to a limited category of leases.

5.140 But if rates are prescribed and an online calculator is introduced, such a scheme would be unnecessary.
INTRODUCTION

6.1 In this chapter, we continue our explanation of how the valuation regime could be reformed in order to reduce premiums and to improve the enfranchisement valuation process.

6.2 In Chapter 5, we set out three options for a new overall valuation “scheme”. In this chapter, we set out various “sub-options” for those schemes.

6.3 The sub-options concern various different elements or aspects of the calculation of enfranchisement premiums. Each of the sub-options could be incorporated within the three overall valuation schemes set out in Chapter 5. Each sub-option could be incorporated on its own or in combination with others. So whichever “scheme” is adopted, one, some, or all of the “sub-options” could be adopted within it.

6.4 In Chapter 8, we draw together the schemes (from Chapter 5) and the sub-options (from this chapter) to summarise how they relate to each other and could work together. On page 22, we provide a diagram summarising the options for reform.

OVERVIEW OF THE SUB-OPTIONS SET OUT IN THIS CHAPTER

6.5 We divide the sub-options for reform into two categories.

(1) The first category (Sub-options 1 to 4) would (or, depending how they are implemented, could) have the effect of reducing premiums for leaseholders.

(2) The second category (Sub-options 5 to 7) would, in themselves, have the effect of increasing premiums for the particular leaseholders for whom they are relevant, but we put them forward on the basis that they could be adopted alongside other reforms so that the overall effect would be a reduction in premiums for leaseholders.

6.6 All sub-options would also serve one or more of the other policy aims set out in our Terms of Reference, or address one or more of the problems with the current law set out in Chapter 3, for example by simplifying the process, introducing certainty, or reducing the professional costs of an enfranchisement claim.

6.7 The sub-options that we consider in this chapter are:

Reforms that would (or could) reduce premiums

(1) Prescribing rates. We conclude that the enfranchisement process could be made simpler, cheaper and more consistent if capitalisation rates, deferment rates and relativity were prescribed. The level of prescription could be at or below market value.
(2) Capping the treatment of ground rent. We conclude that the extent to which ground rents are taken into account in the valuation of enfranchisement premiums could be capped at 0.1% of the freehold value of the property at the valuation date.\textsuperscript{123} This measure would help leaseholders with onerous ground rents.

(3) Development value. We conclude that leaseholders could be given the option to accept a restriction on future development, rather than pay development value on an enfranchisement claim. If the leaseholders subsequently decided to develop, they could buy out the restriction.

(4) Differential pricing for different types of leaseholder. We conclude that there are drawbacks to a regime that provides for different prices for different categories of leaseholder. Nevertheless, if Government wishes to reduce premiums to a level that cannot be justified for all leaseholders under A1P1, then it is an option that Government could pursue.

Reforms that would, by themselves, increase premiums, but which could be adopted alongside other reforms to reduce premiums

(5) 80-year cut-off in respect of marriage value. We conclude that the 80-year cut-off for marriage value should be retained, otherwise premiums will increase for some leaseholders. However, the cut-off could be removed as part of a package of reforms to reduce premiums overall.

(6) Discount for leaseholders' improvements. We conclude that the discount for leaseholders' improvements should be retained (and applied at the election of the leaseholders where appropriate), otherwise premiums will increase for some leaseholders. However, the discount could be limited or even removed in order to reduce disputes, as part of a package of reforms to reduce premiums overall.

(7) Discount for the risk of holding over. We conclude that the discount for holding over should be retained (and applied at the election of the leaseholders where appropriate), otherwise premiums will increase for some leaseholders. However, the discount could be removed, limited or prescribed in order to reduce disputes, as part of a package of reforms to reduce premiums overall.

6.8 We now turn to discuss each of these seven sub-options for reform.

REFORM TO ELEMENTS THAT WOULD (OR COULD) REDUCE PREMIUMS

6.9 We start by discussing four sub-options for a new scheme which would (or, depending how they are implemented, could) have the effect of reducing premiums for leaseholders.

\textsuperscript{123} We explain at para 3.52 why 0.1% is generally considered as an appropriate level to identify onerous ground rents. See also n 57 above.
SUB-OPTION (1): PRESCRIBING RATES

What do we mean by prescription of rates?

6.10 The calculation of premiums under the conventional valuation methodology depends on certain rates. In broad terms:

(1) the value of the “term” depends on the capitalisation rate;
(2) the value of the “reversion” depends on the deferment rate; and
(3) marriage value and hope value depend on “relativity” or the “no-Act deduction”.

6.11 In Chapter 2, we explained the purpose of those rates in the valuation methodology, and the process by which they are determined. In Chapter 3, we explained the problems that arise from the fact that those rates are variable.

6.12 In the Consultation Paper we explained that:

(1) the enfranchisement process could be made simpler, cheaper and more consistent if capitalisation rates, deferment rates and relativity (or the “no-Act deduction”) were prescribed; and
(2) the prescription of rates\textsuperscript{124} could be directed at two different outcomes, either:
   (a) to produce enfranchisement premiums that reflect the market value of the asset, by prescribing rates at market levels; or
   (b) to reduce enfranchisement premiums to below market value (to favour leaseholders), by prescribing rates at below market levels.

6.13 Prescription of rates aimed at market levels would not have the overall effect of reducing premiums, but it would have other valuable benefits for landlords and leaseholders. Prescription of rates at below-market levels would deliver those same benefits, but would also reduce premiums for leaseholders.

6.14 We talk about prescribing a rate, but that could include prescribing more than one rate, depending on the features of the asset in question. For example, different rates could be prescribed for different parts of the country, or in respect of different levels of ground rent in leases. In the Consultation Paper, we asked how rates should be prescribed and what variations there should be.

6.15 As we explain in Chapters 4 and 5 of this Report, if rates are to be prescribed for use in all cases, it would also be necessary for Government to create a requirement in the legislation that the conventional valuation methodology be used in all cases.\textsuperscript{125} That is because those rates are only relevant if that conventional valuation methodology is used. If valuers were free to use other valuation methodologies, then the prescribed

---

\textsuperscript{124} Relativity is not, strictly speaking, a “rate”, but we use that term as shorthand to cover capitalisation rates, deferment rates and relativity (or the no-Act deduction).

\textsuperscript{125} See paras 4.8 to 4.10 and Option 4 (para 5.124).
rates could simply be by-passed by the use of an alternative valuation methodology. Reforms to reduce premiums could, in this way, be rendered ineffective.

6.16 In this section, we summarise the benefits of prescribing rates and consultees’ views on doing so. We then set out the options that are available to Government to prescribe rates.

6.17 The scope of our work in relation to the prescription of rates involves looking at whether those rates should be prescribed as a question of policy and the process through which that could be done. For the reasons we gave in Chapter 4, our role is not to identify the rate or rates that should be prescribed. That will be a question for Government in the event that it decides to prescribe rates.

The benefits of prescribing rates (at, or below, market levels)

6.18 We explained various problems with the current law in Chapter 3. Prescribing rates would solve many of them. These benefits would be achieved whether rates are prescribed at market value, or below market value. The benefits would be enjoyed by all leaseholders – particularly ordinary home-owners (as opposed to investors) – but many of these benefits would be enjoyed by landlords too.

Simplicity

6.19 At present the matters most commonly disputed in routine enfranchisement claims are (1) the freehold (FHVP) value of the property, (2) capitalisation rates, (3) deferment rates, and (4) relativity. If (2), (3) and (4) were prescribed, only freehold value would need to be agreed between the parties or determined by the Tribunal.

Agreeing or determining the freehold (FHVP) value of a property

The FHVP value, or capital value, of a property is relatively easy to ascertain for standard properties: see paragraph 2.32 above. In many cases, especially where properties are uniform, sufficient information can be obtained from internet research, from HM Land Registry, and/or from local estate agents. Where properties are unusual in character the assessment of FHVP value would be more involved, but no more so than at present.

6.20 So, prescribing the three rates would make enfranchisement valuation far simpler and straightforward than it is at present.

Certainty

6.21 If rates are prescribed, in standard cases, leaseholders and landlords will be able to assess in advance, possibly with the aid of an online calculator and without professional assistance, what the enfranchisement premium will be.

(1) If the FHVP is agreed, then the premium will be fixed (subject to some potential exceptions: see further Sub-options 6 and 7 below).
Figure 24: enfranchisement premiums if FHVP value is agreed

Houses 1, 2, 3 and 4 have a FHVP value of £250,000. If the rates are prescribed,\(^{126}\) then the leaseholder and landlord will know that the enfranchisement premium will be:

- in the case of House 1, £4,147;
- in the case of House 2, £16,453;
- in the case of House 3, £9,557;

(2) Even if the FHVP is not agreed, leaseholders and landlords are likely to know, or can fairly easily find out, the likely range within which the FHVP value will lie. For example, based on their own research or discussions with local estate agents, the leaseholders in our examples are likely to know that their properties are worth somewhere between £230,000 and £270,000. If rates are prescribed, then those FHVP figures can be used in order to calculate the minimum and maximum enfranchisement premium.

Figure 25: enfranchisement premiums if FHVP value is not yet agreed

For Houses 1, 2, 3 and 4, if the FHVP is not yet agreed (or determined by the Tribunal), the leaseholder is still likely to know that it will be somewhere between £230,000 and £270,000.

If the rates are prescribed,\(^ {127}\) then:

- in the case of House 1, the leaseholder will know that the enfranchisement premium will be between £3,963 (if the FHVP value is £230,000) and £4,331 (if the FHVP value is £270,000). That can be contrasted with the position in Figures 10 and 14 above, where the rates are not prescribed: all the leaseholder knows is that the enfranchisement premium is likely to be between £1,940 and £10,984.

- in the case of House 2, the leaseholder will know that the enfranchisement premium will be between £15,208 (if the FHVP value is £230,000) and £17,696 (if the FHVP value is £270,000). That can be contrasted with the position in Figures 10 and 14 above, where the rates are not prescribed: all the leaseholder knows is that the enfranchisement premium is likely to be between £10,069 and £27,327.

- in the case of House 3, the leaseholder will know that the enfranchisement premium will be £9,557 (whether the FHVP is £230,000 or £270,000) because the lease is so long the freehold value makes next to no difference to the enfranchisement premium. That can be contrasted with the position in Figures 10 and 14 above, where the rates are not prescribed: all the leaseholder knows is that the enfranchisement premium will be between £4,739 and £15,364.

- in the case of House 4, the leaseholder will know that the enfranchisement premium will be £79,425 (whether the FHVP is £230,000 or £270,000) because the lease is so long the freehold value makes next to no difference to the enfranchisement premium. That can be contrasted with the position in Figures 10 and 14 above, where the rates are not prescribed:

\(^{126}\) At the rates used in Figure 9 above (para 2.54).

\(^{127}\) At the level set out in Figure 9 above (para 2.54).
all the leaseholder knows is that the enfranchisement premium will be between £18,736 and £184,059.

6.22 We have explained above that ascertaining the FHVP value of a standard property is relatively easy. 128 Accordingly, if rates are prescribed, the issues open for discussion and disagreement between the parties, or between their valuers (if they choose to engage a valuer), will be considerably reduced for both simple and more complicated enfranchisement claims. Leaseholders would be less daunted by the uncertain financial outcome of the claim, 129 and the stakes would no longer be so high. 130

Consistency

6.23 If rates are prescribed, enfranchisement claims involving similar issues will be dealt with in exactly the same way regardless of:

(1) the identities of the landlord and the leaseholder, including their level of experience of enfranchisement, and respective bargaining positions;

(2) whether either, or both, are represented by a valuer;

(3) the relative quality of that valuer’s advice;

(4) the valuers’ negotiation skills;

(5) the negotiating position and bargaining power of the parties;

(6) the financial resources of the parties; and

(7) the location and make-up of Tribunal panels.

6.24 At present, each of these factors – which have nothing to do with the market value of an asset – can affect the way in which an enfranchisement premium is calculated. 131

Removing unfair incentive structures and inequality of arms

6.25 Currently landlords often have more to lose by reaching compromise settlements, or more to gain by litigation; a small difference in an individual premium could have a big impact on receipts from future claims in relation to their estate as a whole. 132 The cost of a hearing may be proportionate to what is at stake for the landlord but not for the leaseholder. Prescribing rates would remove the unbalanced and unfair incentive structures that currently exist.

---

128 See para 6.19 above.
129 See para 3.29 onwards above.
130 See para 3.35 onwards above.
131 See paras 3.13 and 3.31 above.
132 See para 3.48 onwards above.
Similarly, during negotiations, either side (or their valuer) may use the threat of a Tribunal hearing as a bargaining tool to improve the settlement they hope to reach.\textsuperscript{133} Prescription of rates would narrow down the issues in dispute and so reduce the opportunity for these bargaining counters to influence the outcome of an enfranchisement claim.

**Reduced costs and delays for leaseholders and landlords**

6.27 It is expensive to pay for professionals to argue over capitalisation rates, deferment rates and existing lease relativity. It is even more expensive if those matters have to be determined by a Tribunal. The process also takes a long time.\textsuperscript{134}

6.28 Prescribing rates would mean that leaseholders and landlords need less, or no, professional assistance from valuers, resulting in significant costs savings (in respect of negotiation and litigation costs), and also reducing the time it takes to complete an enfranchisement claim. Whist a reduction in professional costs would be beneficial for leaseholders and landlords, it would of course result in a reduction in income for valuers.

**Reduced costs for leaseholders**

6.29 Prescription of rates may further reduce professional costs for those leaseholders whose valuers charge performance-related negotiation fees. These fees are based on a percentage of the “saving” between the landlord’s opening quote and the eventual settlement premium. Once negotiations start, any extreme positions taken by the landlord on any issue (including capitalisation rates, deferment rates and existing lease relativity) will usually be dropped and the enfranchisement premium will immediately reduce, which is good news for the leaseholder in terms of the enfranchisement premium payable, but results in a corresponding increase in the fee that has to be paid to the valuer. Prescription of rates should, indirectly, limit the fees that these leaseholders have to pay to the valuers that they instruct.

**Reduced litigation**

6.30 If rates are prescribed, tribunals would rarely, if ever, be required to determine matters relating to those rates. Accordingly, a significant number of disputes that are currently determined by the Tribunal would never arise.

**The benefits of prescribing rates below market levels**

6.31 The benefits that we have set out above would be achieved regardless of the level at which rates are prescribed. Those benefits arise by reason of a rate – which is currently variable – becoming fixed. All of the benefits we have identified would be enjoyed by leaseholders and many would be enjoyed by landlords too (such as reduced professional costs).

6.32 The significant benefits, particularly for leaseholders, of prescribing rates, even at market levels, should not be underestimated. Certainty, simplicity, and removing the

\textsuperscript{133} See para 3.50 onwards above.

\textsuperscript{134} See para 3.37 onwards above.
inequality of arms that currently exists, would be of huge benefit to many ordinary leaseholders seeking to make an enfranchisement claim.

6.33 But in terms of the actual premium that is ultimately paid, prescribing rates at market levels would not, by itself, reduce premiums. In certain individual cases, enfranchisement premiums will be lower or higher than they would otherwise have been. But ultimately, prescription of rates at market levels would broadly reflect current enfranchisement premiums. Accordingly, in order to reduce premiums for leaseholders across the board, it would be necessary for Government to prescribe rates at below-market values.

6.34 If rates were prescribed at a level that was deliberately below the market value, then the enfranchisement premium payable by leaseholders would reduce. There would be a corresponding loss for landlords, whose income from enfranchisement premiums would go down.

Consultation responses concerning prescription of rates

6.35 There was majority support for prescription from a good cross-section of consultees including leaseholders and other members of the public, representative bodies, landlords, lawyers and valuers. Those in favour of prescription mostly thought it should apply to all three rates.

6.36 There were comments regarding both prescription at market rates, which was widely supported, and prescription below market rates, which was supported by leaseholders but not by landlords.

6.37 Of those consultees who opposed the prescription of rates, there were two broad themes that emerged from the responses.

6.38 First, there was opposition – principally from landlords – to prescription of rates at below-market levels. Those consultees raised arguments about the unfairness, in their view, of reducing enfranchisement premiums.

"We consider that deferment rates should not be prescribed with the objective of reducing the premiums payable. We consider that this will unlawfully interfere with the rights of landlords and contravene A1P1. We consider that rates can be set by a body of experts by reference to prevailing market rates which would take account of movements in other asset classes, such as LIBOR or gilts. The proposal to make the process cheaper for the leaseholder (unfair to the landlord) will result in a windfall profit to the leaseholder who is lucky enough to hold the lease at the time of enfranchisement, by reducing the cost on the one hand and increasing the market value of the property on the other. This compulsory transfer of value is unjust to the stakeholders represented by the landlords many of whom are institutions such as pension funds whose assets will consequently be impaired resulting in a reduction in capital available to pay their pension liabilities". (Consensus Business Group, a commercial investor)

6.39 We have explained the competing views of landlords and leaseholders on the question of whether premiums should be reduced in Chapter 3 above. Those same views were expressed on the question of whether rates should be prescribed at below-market levels. We do not repeat those arguments here.
6.40 Second, there was opposition – principally from valuers and landlords – to the very concept of prescribing rates. The idea of setting a standard rate to be adopted in all cases is anathema to a valuer, whose career has been spent assessing, advising on, negotiating, arguing about, and giving expert evidence about, the value of an individual asset, with all of its unique attributes.

6.41 We address these general comments opposing prescription first, before turning to the views of consultees about whether and how particular rates should be prescribed.

6.42 We acknowledge that valuers who oppose prescription of rates have a principled basis for doing so. We also note, however, that, if rates are prescribed, much of the work currently undertaken by valuers in enfranchisement claims will be unnecessary. Just as landlords do not want to see their income from enfranchisement premiums reduce, nor do valuers who practise in this sector want to see their workstream and resultant fee income reduce or disappear.

A culture change: moving from individual tailored valuations to general valuations

6.43 Opposition to the idea of prescribing rates came, in particular, from valuers who have been used to providing tailored valuations and then defending their choice of rates, both in negotiations and sometimes before tribunals and the courts.

“To fail to take into account the complexities of the valuation process will result in a totalitarian style theft of assets and a massive injustice to the freehold investor. I am appalled that you can consider this sort of tyranny. Please apply the correct market values. Nothing more, nothing less will achieve fairness”. (Jupiter Investments Ltd, a commercial investor)

“Prescription of deferment rates would be too arbitrary given the variation in location and quality of property involved. I see nothing wrong with the current system whereby it has changed over time and location as a result of judicial determination”. (Carter Jonas LLP, surveyors)

“No no no! Valuations undertaken are an attempt to assess the market value and the rates used reflect this and are free to be adjusted and [tested] by tribunal decisions. Market and economic factors can change these. They should not be set”. (Sarah Foster, a surveyor)

“The capitalisation rate to apply to any ground rent income is a matter for valuation opinion, not prescription”. (Scrivener Tibbatts, surveyors)

6.44 Prescription of rates would move away from the current approach of providing tailored valuations towards a more general assessment of the value of an asset. Enfranchisement premiums would be valued in a generally correct way rather than a precisely correct way. With prescription of rates (at market value) there would be some winners and some losers, but there would also be far more consistency in the way that claims are dealt with overall. That consistency and certainty would bring with it a reduction in professional costs and litigation costs for all parties.

6.45 Prescribed rates would not be tailored for a particular building. We explained in Chapter 2 that the selection of deferment and capitalisation rates currently takes account of the nature of the property in question. But we also explained that the equivalent task of arriving at a present value of a future receipt or income stream is done in other contexts (see paragraphs 2.15 and 2.35); setting capitalisation and deferment rates could
arguably be a matter of economic technique (familiar to people such as the Government Actuary) as much as a matter of surveying expertise.

Does the current approach lead to the "correct" valuation?

6.46 We explain the valuation methodology and process in Chapter 2. The end result is a single figure which is the enfranchisement premium in that particular case. However:

(1) the methodology gives rise to a range of possible outcomes. The outcome depends on a range of inputs, such as the rates that are selected. Despite the strongly held views of valuers, it is important to understand that there is no "definitively correct" capitalisation rate, deferment rate or relativity for any lease length or set of circumstances. The valuation of enfranchisement premiums is based on the opinions of valuers, and opinions – quite legitimately – differ. There is no single objective truth. So valuers disagree, and disputes have to be settled by negotiation or resolved by the Tribunal.

(2) the process itself gives rise to a yet further – and wider – range of possible outcomes. The outcome will also be influenced by a range of additional factors that come in to play, such as the negotiation process and strength of the parties’ respective bargaining positions: see paragraphs 3.31 to 3.51 and 6.23. The process set out in Chapter 2 involves valuers advancing arguments which are intended to achieve the best possible outcome for their clients; they negotiate, bargain, and exert any influence that they, or the parties, might have. In the minority of cases, valuers get to the point of giving expert evidence to the Tribunal, at which point they are required to give their objective opinion about the correct valuation. But until that point (and therefore in the majority of cases) they are not seeking to arrive at the "correct" outcome; rather, they are seeking to arrive at a solution that is in the best interests of their client (whether that is the landlord or the leaseholder).

6.47 So whilst enfranchisement premiums are meant to reflect the correct market value for the landlord’s asset, there is no single definitive market value. Instead, there is a range of opinions as to what constitutes the market value. The same case could, therefore, give rise to a range of possible outcomes. Range A in Figure 26 below, reflects the fact that the methodology can give rise to a range of different outcomes, all of which can be said to reflect the market value. Range B in Figure 26, reflects the fact that the process can give rise to an even wider range of different outcomes, which might not reflect any view of the correct market value.
6.48 In so far as the policy aim (and the desire of many landlords and valuers) is for enfranchisement premiums to reflect the market value of the asset:

(1) where the outcome is within Range A, the outcome is arguably acceptable; the range of outcomes is the inevitable consequence of valuation being a matter of opinion, and a tailored enfranchisement premium has been found in the particular case. Equally, however, it is arguable that prescribing rates to remove that scope for argument is a more acceptable approach because it provides certainty and consistency.

(2) where the outcome is outside Range A and within Range B,\textsuperscript{135} however, the outcome is not acceptable; the outcome is not the result of legitimate differences of expert opinion about market value, but instead the result of other factors (such as the parties' relative bargaining powers) that should not be relevant to the true market value of the asset.\textsuperscript{136}

\textsuperscript{135} That is, within the dotted line in Fig 26 above.

\textsuperscript{136} Fig 26 shows that these additional factors can result in a premium that is higher or lower than Range A. As we have explained in Chapters 1 and 3, it is generally the leaseholder who is in the weaker bargaining
6.49 So the current regime, despite its aims, does not always give rise to premiums that reflect the market value.

6.50 Prescribing rates would result in the enfranchisement premium being set. The current scope for variation within Range A or Range B would not exist because prescription would remove the variables which arise from the methodology and the process.

6.51 Rates could be prescribed at market levels or below market levels.

(1) Prescribing rates at market levels (that is, somewhere within Range A) would result in fixed premiums which could be possible outcomes under the current law.

(2) Prescribing rates slightly below market levels (in so far as the rate reflects current premiums which are outside Range A and within Range B) would also result in fixed premiums which could nevertheless be possible outcomes of enfranchisement claims under the current law, given that much currently depends on a range of variable factors.

(3) Prescribing rates a long way below market levels (namely below Range B) would result in fixed premiums which do not occur under the current law.

6.52 In summary, the current approach to valuing enfranchisement premiums does not result in the "correct" figure. That is because (a) there are legitimately different views on what that correct figure is, and (b) other factors influence the way in which enfranchisement premiums are agreed or determined.

6.53 Accordingly, in our view, the mere fact that prescribing rates removes the scope for a tailored valuation of the particular asset in question would not involve a move away from a system which currently produces the "correct" results.

Does prescription of rates give rise to arbitrary results?

6.54 One of the arguments often made by consultees who opposed the prescription of rates was that the current valuation regime provides a tailored valuation for the particular asset that is being acquired from the landlord. But as we explained above, and in Chapter 3, the outcomes under the current regime can in fact be arbitrary. So whilst prescription of rates does involve generalisation, it also avoids the problems of arbitrary outcomes that currently arise as a result of a range of factors that should have nothing to do with the true market value of the asset.

6.55 We do not therefore accept the argument that prescribing rates would amount to replacing a system that currently works accurately and well with an arbitrary one. For the reasons set out in paragraphs 6.46 to 6.53 above, it is not the case that the current system is perfect and always produces an enfranchisement premium that exactly reflects the true market value of the asset. Rather, there are different views on what is the true market value, and numerous other factors come in to play in setting an

position, and so these additional factors will generally result in premiums that are higher than Range A. But that is not always the case; for example, if the landlord of a block of flats is a group of leaseholders, then a large buy-to-let investor who owns the long leases of multiple flats in the block might be in a stronger bargaining position than the landlord. In those circumstances, the additional factors might result in a premium that is lower than Range A.
enfranchisement premium which should have nothing to do with the market value of the asset. Accordingly, in many ways, the current valuation regime results in enfranchisement premiums that are arbitrary. So, whilst a regime based on a prescribed rate (or set of rates) is said by its opponents to be arbitrary, arguably it would actually create less arbitrary results than the current approach because the outcomes would be consistent, and would not depend on arbitrary factors.

**Prescription of capitalisation rates**

6.56 Capitalisation rates would feature in valuations under each of Schemes 1, 2 and 3 (in Chapter 5) since they all include the calculation of the value of “the term”, which depends on a capitalisation rate. In the Consultation Paper we invited the views of consultees as to whether capitalisation rates should be prescribed and, if so, how, by whom, how often, and in respect of what different types of interest.137

**Consultees in favour of prescribing capitalisation rates**

6.57 A sizeable majority of consultees who provided substantive responses138 supported prescription of capitalisation rates, saying either that it was a good idea or that it could, or would, work in practice.

6.58 Support for prescription was expressed by a range of different consultees. Those in favour included leaseholders and their representative bodies (including the Leasehold Knowledge Partnership and the National Leasehold Campaign), some legal professionals and surveyors, many commercial investors, and a few consultees from the charitable sector.

> “We support the proposal to prescribe capitalisation and deferment rates. Doing so will promote transparency, simplicity and will reduce the scope for disputes. This will result in enfranchisements and lease extensions being simpler and more cost effective. Combined with an online calculator it will also enable a leaseholder to know the approximate cost of an enfranchisement prior to commencing the process as it won't be down to a tribunal to determine the rate (which is currently the case for the capitalisation rates)”. (Rothesay Life, a commercial investor)

> “Capitalisation rates being legally set would save professional fees for all parties, and so are desirable”. (Bretton Green Ltd, a commercial investor)

6.59 Consultees also said that prescribing rates would have significant benefits for leaseholders.

> “This is another area of valuation methodology that is incomprehensible to the average leaseholder. The scales are so heavily tipped in favour of the freeholder, who has the deep pockets to employ top barristers, economists, and others to set case law for low capitalisation rates to ensure high enfranchisement premiums. Leaseholders really have no defence against this. If capitalisation rates are set, they need to reflect the capitalisation rates that have been used in recent years for valuation purposes; 7-8% to ensure that enfranchisement premiums are attainable for leaseholders. Setting rates at this level will help leaseholders immensely and

---

137 Enfranchisement CP, para 15.71.

138 By which we mean responses that addressed and answered this question.
needs to be done quickly before freeholders successfully set case law for lower rates”. (Jo Darbyshire, a leaseholder)

“Cap rates need to be prescribed as a matter of urgency. It is only recently, with freeholders introducing onerous ground rents with very aggressive accelerators that disputes over [capitalisation] rates have arisen”. (Leasehold Knowledge Partnership, a leaseholder representative body)

“Leaseholders do not individually have the financial resources to compete against the freeholders”. (Parthenia, surveyors)

6.60 Some consultees expressed general support for prescription of capitalisation rates but only on the assumption that rates are set at market levels, and provided that they are set, and then subsequently reviewed, by an appropriate panel of experts or linked to other rates in the financial market.

Consultees opposed to prescribing capitalisation rates

6.61 Consultees who were against prescription of capitalisation rates included the Leasehold Forum (a body representing enfranchisement professionals), many firms of valuers, several commercial landlords, some investors, and a few individuals.

6.62 There were five main arguments against prescribing capitalisation rates. First, the main opposition was based on the view that each claim should be valued on its merits and driven by market forces. We have addressed that argument in paragraph 6.43 onwards above. Second, some consultees opposed prescription of rates in so far as it would reduce enfranchisement premiums, or fail to reflect the low-risk nature of freehold investments. We have discussed those arguments in Chapter 3.

6.63 Third, it was suggested that prescribing capitalisation 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 capitalisation rates that are, in fact, below market values. The argument, brought to the fore by the recent All Saints\textsuperscript{139} decision in which the capitalisation rate was determined at 3.35% (see paragraphs 2.70 and 4.22 above), is that capitalisation rates at market value should in fact be lower than the 5-8% range at which they have previously commonly been agreed at.

“In the current low interest rate environment there are good reasons, from both an academic and valuation perspective, for capitalisation rates to be lower than the current range generally adopted. Following the All Saints decision I suspect that a committee of economists, academics and valuers etc. may adopt prescribed rates that are lower than those currently adopted. This will increase rather than decrease the cost to leaseholders and is contrary to the Government’s objectives.” (Richard Stacey, a surveyor)

“Given the current low base rates, there is good valuation argument for suggesting that even fixed ground rent income traditionally capitalised at between 6% and 8%, depending on location should be capitalised at a lower rate.” (Scrivener Tibbatts, surveyors)

6.64 This argument demonstrates exactly why prescription of rates would be helpful – the current uncertainty about what rate amounts to “the market rate” leads to uncertainty

\textsuperscript{139} St Emmanuel House (Freehold) Ltd v Berkeley Seventy-Six Ltd CHI/21UC/OCE/2017/0025.
for leaseholders and can be used as a bargaining counter (principally) by landlords: see Chapter 3.

6.65 If enfranchisement premiums are currently being agreed based on below-market rates, then we accept that prescribing rates at market levels would result in premiums increasing from their current levels. A solution to that problem would be to take the rates that are currently being used and prescribe rates at that level, acknowledging that the prescribed rates are below market levels, but that the outcome is that enfranchisement premiums will stay at broadly the same levels as they are now. Or rates could be prescribed at lower levels in order to reduce enfranchisement premiums compared to their current levels. That is a matter exclusively for Government.

6.66 But in any event, it might be questioned whether prescribing rates at their current levels would in fact amount to setting rates at below-market value. As we have noted, valuers will have different views as to what the market rate is, and so the level at which capitalisation rates are currently being agreed could be viewed as being reasonably representative of the current market rate (that is, after all, exactly what the rates are meant to be: see Chapter 2). Accordingly, prescribing rates at their current levels might not amount to setting rates at below-market levels at all.

6.67 Fourth, it was suggested that the capitalisation rate is rarely disputed by the parties and so it is unnecessary to prescribe the rate, and the costs of doing so would be disproportionate to the benefits.

“There are very few [tribunal] cases on [capitalisation] rates - one recent one All Saints but apart from that none for years. The reason is valuers agree these rates depending on the market and comparable evidence”. (Stewart Gray, a surveyor)

“As it is common place for capitalisation rate to not be a substantial issue in dispute and is one of the key issues most regularly agreed with minimal negotiations it would seem unnecessary to prescribe same. It would also seem to be a costly exercise as that will then require regular review and that would seem to be a waste of public money when there are so few disputed cases over this variable”. (Saul Gerrard, a surveyor)

6.68 In our view, these arguments miss the point of prescribing the capitalisation rate. We accept that disputes about the capitalisation rate rarely reach the Tribunal. And it may be the case that the capitalisation rate is regularly agreed between valuers who have started negotiations. But the problem with the current regime is at a much earlier stage: the problem is that the capitalisation rate is variable so there is scope to argue the point. That means that (1) there is uncertainty in the first place, which can be used as a bargaining tool and which gives rise to quotations or estimates from landlords which are daunting for leaseholders (see Chapter 3), and (2) there is a need for the parties to appoint valuers in order to engage in that negotiation process, which would be unnecessary if the rate were prescribed.

6.69 Fifth, some consultees seemed to oppose prescription of rates on the basis that a single rate could not fairly be used for the wide range of assets to which the rate will apply. As explained in paragraph 6.14 above, when we refer to prescribing rates, we are not suggesting that there would have to be one single rate that would apply in all circumstances; we acknowledged in the Consultation Paper that there could be different rates in different circumstances. It is responses to that question to which we now turn.
How should capitalisation rates be prescribed?

6.70 If Government decides that rates should be prescribed, then it will need to consider how to do so. Consultees gave a variety of views about how capitalisation rates should be prescribed. We summarise those views for Government to consider.

(1) Some gave their views about what the capitalisation rate should be, with suggestions ranging from 3% to 10%. As we explain in Chapter 4, it is not for us to comment on what the rate should be.

(2) Some suggested that the prescribed rate should track some other rate in the market.

“For short leases, the obvious capitalisation rate should be the equivalent gilt rates. For longer leases, then the 10-year gilt rate should be used.” (Bretton Green Ltd, commercial investor)

It should be “based on a long-term interest rate equivalent to the term of the lease”. (Philip Rainey QC, barrister)

(3) Some commented that different capitalisation rates ought to be used for different types of rent review provision in leases: see paragraph 2.17 onwards above.

“The appropriate capitalisation rate is dependent on the quantum, the frequency of payment, the opportunity for growth through the term, the rent review mechanism, all of which has to be compared to alternative types of investments. Therefore it is inappropriate to set a single rate for all rents”. (Prosper Marr-Johnson, a surveyor)

“Capitalisation rates in the market vary between income and property type. Hence it will be very difficult to prescribe a 'one size fits all' rate. Different types of income will need differing prescribed rates”. (JLL, surveyors)

(4) Some consultees commented on whether there should be regional differences in capitalisation rate. Most favoured a single capitalisation rate nationwide, but a few felt that this could be too broad-brush and suggested instead that there should be different capitalisation rates for different parts of the country.

(5) Consultees generally favoured one body having responsibility for setting all three rates (the capitalisation rate, the deferment rate and relativity). Proposals included many variations on an external, independent, professional, expert body, together with more specific suggestions such as Government, the Office for National Statistics, the Upper Tribunal and the Royal Institution of Chartered Surveyors (“RICS”).

---

140 Some of these views were expressed in the context of opposition to prescription; for example, some consultees opposed prescription because they said that different rent review provisions in leases justified different capitalisation rates.

141 If rents are to be capped at 0.1% of the freehold value (see further paragraph 6.119 onwards below), then the need for – and possible range of – different rates reduces.
Consultees had different views on how often the rate should be set and their suggestions varied from daily (linked to an easily ascertainable rate) to fixed without review. The most popular choice was five-yearly.

Prescription of deferment rates

Deferment rates would feature in valuations under each of Schemes 1, 2 and 3 (in Chapter 5) since they all include the calculation of the value of “the reversion”, which depends on a deferment rate. In the Consultation Paper we invited the views of consultees as to whether deferment rates should be prescribed and, if so, how, by whom, how often, and in respect of which geographical areas.142

Preliminary point: the relevance of Sportelli

Many consultees commented that, following the decision in Sportelli,143 deferment rates were already effectively prescribed nationwide. One consultee commented that that was not necessarily a positive thing:

"Arguably Sportelli, by ascribing a UK wide rate in a case concerning central London evidence has caused some of the problems we see from the housebuilding sector. It has perhaps underwritten investment values outside of central London as a result and may have caused pension funds and other institutions to overpay for these assets." (Cluttons, surveyors)

The fact that Sportelli effectively prescribes the deferment rate gave rise to a variety of different, and contradictory, conclusions from consultees.

(1) Some consultees thought that, as a result of Sportelli, there was nothing novel or objectionable about prescribing the deferment rate.

(2) Some thought that prescribing the deferment rate at the level in Sportelli would be beneficial since it would provide certainty for landlords and leaseholders.

"Our suggested solution is therefore to prescribe deferment rates at the current Sportelli rates, on the basis that leaseholders would be protected from any potential increase in premiums resulting from a lower deferment rate applying in the future and landlords would have some security in so far as they would know that prescribed deferment rates would be no higher than the current Sportelli rates." (Gerald Eve LLP, surveyors)

(3) Some thought that, as a result of Sportelli, it was unnecessary and disproportionate to prescribe the deferment rate.

"… deferment rates have effectively been prescribed since the decision in Sportelli … and therefore prescribing a deferment rate would not do anything to simplify the valuation process as it stands." (Leasehold Forum, a body representing enfranchisement professionals)

---

142 Enfranchisement CP, para 15.75.
Some thought that it would be unfortunate to lose the flexibility that still exists following Sportelli. There is room to argue, in appropriate cases, for a different deferment rate.

“It would … restrict valuers from deviating from a given rate in a situation where there is a compelling reason to adjust the rate either upwards or downwards. Further, the generic deferment rate of 4.75% for houses and 5% for flats determined in the Sportelli case applies to leases with more than 20 years remaining. Prescribing a deferment rate has the disadvantage of restricting valuers in claims with reversions with less than 20 years remaining, where useful market evidence may be available to assist in assessing the present value of the reversion.” (Leasehold Forum, a body representing enfranchisement professionals)

“… obsolescence in a building is relevant and a prescribed rate could not take this into account. This could be very unfair to leaseholders.” (Fanshawe White, surveyors)

“In complex cases there are situations where it is appropriate to deviate from the Sportelli rate, particularly if there is an intermediate interest with a set reversionary term. Therefore a certain amount of flexibility is necessary.” (Prosper Marr-Johnson, a surveyor)

Consultees in favour of prescribing deferment rates

6.74 The vast majority of consultees who responded substantively supported prescription of deferment rates, saying either that it was a good idea or that it could, or would, work in practice. As was the case with capitalisation rates, support for prescription of deferment rates was expressed by a number of different types of consultees. Consultees in favour of prescription included representatives of leaseholders, the British Property Federation, several lawyers, many valuers, many commercial freeholders, several charity freeholders, and some members of the public, including leaseholders.

“We agree with the principle that an easily discernible deferment rate is an important element in arriving at quicker, easier and more cost-effective valuations.” (British Property Federation)

“A prescribed method, which tracks market movements, reviewed frequently, geographically specific would simplify the process.” (Wellcome Trust, charitable sector)

6.75 Groups representing leaseholders were in favour of prescribing rates (if “the reversion” is to remain part of the calculation of enfranchisement premiums), provided the rate adopted resulted in premiums being reduced.

“The scales are so heavily tipped in favour of the freeholder, who has the deep pockets to employ top barristers, economists, and others to set case law for low deferment rates to ensure high enfranchisement premiums. Leaseholders really have no defence against this.” (National Leasehold Campaign, a leaseholder representative body)

“Sportelli set the deferment rate but based on existing leasehold assumptions which make it unacceptable to leaseholders. It is based on constructed nonsense. Reversion is a 14th century legal construct which has earned freeholders many billions of pounds over the years. It needs to be abolished completely. Reversion is based on a land owner’s perpetual rights to own the land and do with it as they please. We freely accept that land owner’s rights have been altered in nearly all other aspects like the type of buildings that can be erected, environmental rights, fracking rights, the rights of access in public buildings and height and depth a land owner continues to exert their ownership rights. Reversion needs to be ended. If a deferment rate has to be prescribed it should be done so to reduce the payments due by
leaseholders as this is clearly in the public interest. We suggest 6% in [Prime Central London] and 6.5% for the rest of the country”. (Leasehold Knowledge Partnership, a leaseholder representative body)

6.76 As with prescription of capitalisation rates, some consultees said that it was important that any prescribed deferment rate was subject to review.

“No rates should remain immutable over time and changing circumstances should allow for amendment.” (British Property Federation)

Consultees opposed to prescribing deferment rates

6.77 A significant minority of consultees were against prescription of deferment rates for a variety of reasons. These included the Leasehold Forum, a couple of lawyers, many valuers, several commercial freeholders and investors, and a few individuals.

6.78 There were five main arguments against prescribing deferment rates, all of which duplicated the reasons why consultees opposed prescribing the capitalisation rate: see paragraph 6.61 onwards above. First, there was opposition based on the view that each claim should be valued on its merits. Despite the fact that deferment rates are considered to be effectively prescribed by Sportelli, there remains scope for argument. Some consultees saw that as a positive thing; as noted in paragraph 6.73(4) above, some consultees commented on benefits of the continuing (albeit reduced) flexibility in setting the deferment rate. We have explained in Chapter 3 above the problems with a rate being variable, as well as the fact that scope for tailored valuations in fact creates arbitrary results (see paragraphs 6.43 to 6.55 above).

6.79 Second, there was opposition to prescription of rates in so far as it would reduce enfranchisement premiums, and we have addressed those arguments in Chapter 3 above.

6.80 Third, 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.

“Prescribed rates will result in winners and losers, depending on whether they fall above or below the line / rate. In the current low interest rate environment there are good reasons, from both an academic and valuation perspective, for deferment rates to be lower than Sportelli. Following the Lord Chancellor’s decision in 2017 to change the discount rate, from 2.5% to -0.75%, I suspect that a committee of economists, academics and valuers etc may adopt prescribed rates that are lower than Sportelli. This will increase rather than decrease the cost to leaseholders and is contrary to the Government’s objectives.” (Richard Stacey, a surveyor)

“The general consensus, certainly within [Prime Central London], is that the rate … would now warrant review and any such review would likely lead to a rate that is substantially less than the rate in Sportelli. It follows therefore that seeking to adopt a rate based on the present market is more likely to increase rather than decrease the premium. There would need therefore to be political interference to adopt a deferment rate at a level which reduces the premium”. (Damian Greenish, solicitor)

6.81 As we said in relation to prescription of capitalisation rates (see paragraph 6.64 above), this argument demonstrates why prescription of the deferment rate would be helpful. In
response, just as with the capitalisation rate, the deferment rate could be set at a level that did not in fact result in increased premiums, even if that involves prescribing the rate at (what some valuers consider to be) below-market levels: see paragraphs 6.65 and 6.66 above.

6.82 Fourth, it was suggested that the deferment rate is rarely disputed by the parties and so it is unnecessary to prescribe the rate. For the reasons set out in paragraph 6.68 above, that argument misses the point of prescribing the deferment rate.

6.83 Fifth, some consultees said that a single deferment rate could, in fact, increase premiums for leaseholders – particularly those outside London where deferment rates are commonly agreed at slightly higher levels than the Sportelli rate, resulting in lower premiums. That potential problem can be avoided; just as is the case with capitalisation rates (see paragraph 6.69 above), prescribing the deferment rate could involve prescribing different rates for different parts of the country.

How should deferment rates be prescribed?

6.84 If Government decides that rates should be prescribed, then it will need to consider how to do so. Consultees gave a variety of views about how deferment rates should be prescribed. We summarise those views for Government to consider.

(1) Some gave their views about what the deferment rate should be. Many suggested that the rate should be prescribed at the Sportelli rate, though some suggested that a slightly higher rate (for example, of 5.5%) should be set out of London. But suggestions ranged from as low as 2.25% up to 10%. As we explain in Chapter 4, it is not for us to comment on what the rate should be.

(2) Some suggested the basis on which the rate should be prescribed, for example:

   (a) that the prescribed rate should track some other rate in the market;

   “based on a long-term interest rate equivalent to the term of the lease”. (Philip Rainey QC, barrister)

   “linked to another accepted rate of interest available in the financial market”. (Paul Tayler Ltd and Howard de Walden)

   “reliable gilt / bond with appropriate adjustment”. (David Robson, a surveyor)

   (b) that the prescribed rate should be based on “long-term property and financial evidence”.

   “Long term analysis should be employed by an independent financial historian (the Bank of England has data going back over 300 years). Reference should be made to the property cycle, according to The Economist house prices are 30% overvalued against incomes and 45% against rents according to long term analysis. This should mean deferment rates should be far higher than 4.75% and 5%, as there is a high chance of property values falling and indeed over correcting”. (Parthenia, surveyors)

(3) Of the consultees who commented on whether there should be variation between geographical areas, a significant minority considered that there should not be any regional variation, and a sizeable majority said there should be. Of those in favour
of such a variation, the most popular suggestions were for a distinction between either:

(a) Prime Central London; Greater London; and everywhere else; or
(b) the Midlands and the North; and everywhere else.

(4) Some commented that different deferment rates should be used for different types of property, for example, depending on whether there is more or less than 20 years unexpired (the Leasehold Advisory Service ("LEASE")) or the quality of the building (Julian Wilkins & Co, surveyors). Some consultees who were in favour of a variation gave differences in capital growth rates as a reason, but others pointed out that there was no constant pattern over time to capital growth.

(5) As explained in paragraph 6.70(5) above, consultees were generally in favour of the same body setting all three rates.

(6) Of the consultees who considered that the rates should be reviewed on a regular basis, some made specific suggestions ranging from annually to every 20 years. The most common suggestion was for reviews every five years.

Effect of the deferment rate on relativity

6.85 One consultee (Cerian Jones, surveyor) pointed out the strong link between the deferment rate and relativity, which is especially important following Sportelli.

![Figure 27: Link between the deferment rate and relativity](Image)

Deferment rate and relativity are linked and so a change in the deferment rate in an enfranchisement calculation would result in a change in the relativity of the existing lease. The reason is as follows: in any claim a lower deferment rate would result in a higher value for the freehold reversion and so a higher enfranchisement premium. In turn, that would reduce the price that would be paid for the existing lease, because a prospective purchaser would assess the existing lease value by deducting the likely lease extension premium from the extended lease value (see paragraph 3.20 onwards above). That is why the Sportelli decision, which reduced deferment rates across the country, also increased premiums especially outside central London in areas where deferment rates had previously been much higher.

Prescription of relativity (or the no-Act deduction)

6.86 Relativity (or the no-Act deduction) is relevant to the calculation of marriage value and hope value. It would therefore feature in valuations under Scheme 2, which includes hope value, and Scheme 3, which includes marriage value. But it would not feature in valuations under Scheme 1, which does not include marriage or hope value. In the Consultation Paper we invited the views of consultees as to whether relativity or a no-Act deduction should be prescribed for enfranchisement valuations and, if so, how, by whom, how often, and in respect of which geographical areas.\textsuperscript{144}

\textsuperscript{144} Enfranchisement CP, para 15.79.
Consultees in favour of prescribing relativity (or the no-Act deduction)

6.87 Of the consultees who provided substantive responses, just over half supported prescription of relativity and a no-Act deduction, saying either that it was a good idea or that it could, or would, work in practice. Support for prescription of relativity was expressed by a number of different types of consultees, including legal professionals, surveyors, commercial investors, and other consultees.145

"We consider reference to in-the-market relativity rate graphs provided by a range of professional practitioners/estate agents for geographic areas … with a prescribed and supportable discounts for Act rights, would help address the current uncertainties behind references to graphs". (The Dulwich Estate, The Charity of Richard Cloudesley, and Dame Alice Owen’s Foundation, charitable sector)

"In order to simplify and expedite the valuation process, and cut down on disputes, prescription of some of the components of the valuation could be considered. Relativity could be prescribed although this would contradict the Upper Tribunal’s most recent market led approach as adopted in Sloane Stanley v Mundy. … Relativity has tended not to be constant in the past, but that is probably because of the uncertainty of the premium payable for a lease extension, which impacts the short lease value. So introducing a prescribed graph of relativity would bring some consistency to the market and the valuation of short leasehold interests in general, which would probably be welcomed by valuers and market participants alike." (Cerian Jones, a surveyor)

"CILEx welcomes proposals for this to be set to a fixed relativity model. This shall help to simplify the valuation methodology, eliminate cause for disputes and help to improve consumer awareness around the costs involved within the enfranchisement process". (CILEx, a legal professional representative body)

"I refer back to the Land Tribunal’s decision in Arrowdale when they proposed that the RICS ought to get a working party to agree one graph of relativity. The principle that one graph of relativity is acceptable has therefore been established. Let us be quite honest, none of the graphs are anything other than downright opinion, or somebody’s interpretation of what they call "facts". After 25 years of the 1993 Act the arguments over marriage value are worse than they have ever been in my experience (see the Upper Tribunal decision in Ironhawk). Many attempts have been made to find a solution, all have failed, the only way you will resolve that problem is either to eliminate marriage value or prescribe a graph. Quite frankly, I do not see why you should not draw a straight line between term date (nil years unexpired) to 80 years unexpired and everything above 80 years unexpired gets no marriage value. It's about as fair as you would ever get: landlords will be relieved that it is not being abolished altogether although they would never admit that!" (Bruce Maunder-Taylor, a surveyor)

6.88 Julian Wilkins & Co (surveyors) went further and suggested that the no-Act deduction should be removed altogether.

Consultees opposed to prescribing relativity (or the no-Act deduction)

6.89 Some consultees were opposed to prescription of relativity and a no-Act deduction, including the Leasehold Forum and many valuers. JLL and Nesbitt & Co opposed prescription of relativity but were nevertheless in favour of prescribing the no-Act deduction.

145 The Leasehold Knowledge Partnership and National Leasehold Campaign thought that marriage value should not be payable be leaseholders at all, in which case it would not be necessary to prescribe relativity.
6.90 There were four main arguments against prescribing relativity, the first three of which duplicated the reasons why some consultees opposed prescribing the capitalisation and deferment rates.

6.91 First, there was opposition based on the view that each claim should be valued on its merits.

"Relativity should not be prescribed as the valuation of the existing leasehold interest relative to the freehold value should be assessed by the valuer familiar with the actual property under consideration.” (Leasehold Forum, a body representing enfranchisement professionals)

"... some of the tolerances of the current position in case law (emphasis on local and recent transactions) should continue to be a feature, a concept which may be difficult to realise, for instance if the approach was to be by way of any single graph.” (Association of Leasehold Enfranchisement Practitioners, a body representing legal professionals and surveyors)

"Relativity should not be prescribed as it may result in an existing lease value that is not reflective of the particular property or location.” (JLL, surveyors)

6.92 We have explained in Chapter 3 the problems with relativity and the no-Act deduction being variable, as well as the fact that scope for tailored valuations in fact creates arbitrary results (see paragraphs 6.43 to 6.55 above).

6.93 Second, there was opposition to prescription of relativity in so far as it would reduce enfranchisement premiums, and we have addressed those arguments in Chapter 3.

6.94 Third, it was suggested that relativity is rarely disputed by the parties and so it is unnecessary to prescribe the rate.

"In my ten years’ experience, I have never had a dispute over relativity which has led to a Tribunal for determination. The majority of valuers are able to agree this element without recourse to the Tribunal and can reflect the market and geographical area without needing the rate to be prescribed”. (Marie Joyce-Reidy, a surveyor)

For the reasons set out in paragraph 6.68 above, that argument misses the point of prescribing the deferment rate.

6.95 The fourth argument against prescribing relativity was that it would, in practice, be very difficult and contentious to decide on the level at which relativity should be set. Reference was made to an attempt by a 2009 working party of valuers set up by the RICS to seek to agree a relativity graph.\(^{146}\) It proved impossible for that group to reach agreement. To some extent, this issue was also raised in respect of prescribing capitalisation and deferment rates (since different people have different views on the appropriate rate) – but the comments about the difficulty of deciding on an appropriate rate were particularly pronounced when it came to relativity. That is perhaps because more evidence is available to assist with deciding on an appropriate capitalisation and deferment rate. But with relativity, the concept itself is harder to understand, there are very different views about it (see paragraph 2.44 onwards above), and there is a lack of current market evidence which can support it (see paragraph 3.18 onwards above) –

so the range of different professional views about relativity is even greater than for capitalisation and deferment rates.

How should relativity (and the no-Act deduction) be prescribed?

6.96 If Government decides that rates should be prescribed, then it will need to consider how to do so. Consultees gave a variety of views about how relativity and a no-Act deduction should be prescribed. We summarise those views for Government to consider.

(1) Many consultees commented on which existing graph of relativity should be used.

(a) The Gerald Eve 1996 graph\textsuperscript{147} was mentioned most often – principally by landlords and by valuers who often act for landlords. It would allow relativity to be prescribed in a “fair and comprehensive” manner (Eyre Estate). It was described as the “go-to graph” for Prime Central London or Greater London, followed by the Savills 2015 graphs.\textsuperscript{148} It was suggested by two consultees that adopting the Gerald Eve graph would mean that “leaseholders would be protected in so far as premiums would not be increased by a new graph with lower relativities and landlords would have security in so far as they would know that premiums would not be reduced from current basis”.\textsuperscript{149} Other consultees noted that, although the Tribunal in \textit{Mundy} had concluded that the Gerald Eve graph was the “least unreliable” and had accepted the landlord’s case, the Tribunal nevertheless said that the Gerald Eve graph may overstate relativity, in which case prescribing rates using that graph would in fact fix premiums at below-market levels.

(b) Many central London enfranchisement professionals and commercial freeholders relied on \textit{Mundy} and the Tribunal’s qualified approval of the Gerald Eve graph, but many of those accepted that the graph might not be suitable for use outside central London. Gerald Eve itself referred to the RICS report on relativities in 2009 suggesting that “mortgage dependent properties are subject to different relativity curves than the Gerald Eve 1996 Graph, with no one curve having an application on a nationwide basis. Research would therefore be required to determine a suitable prescribed without-rights curve for properties outside Greater London.”

(c) Parthenia suggested that its model for assessing relativity should be adopted (see paragraph 4.19 above). The effect of doing so would, in many cases, be to reduce premiums significantly for leaseholders. Landlords rejected the Parthenia model, pointing to the Tribunal’s rejection of that model in the \textit{Mundy} decision. For example, the British Property Federation said “any graph based on the Parthenia model has been totally rejected and has no place in any future regime”.

---

\textsuperscript{147} Graph of unenfranchiseable relativities: see para 2.44 onwards and Figs 6 and 7 above.

\textsuperscript{148} Graphs of enfranchiseable relativities and unenfranchiseable relativities; see https://www.savills.co.uk/research_articles/229130/203902-0.

\textsuperscript{149} Gerald Eve and Grosvenor.
Anthony Shamash, an investor, suggested that the Gerald Eve graph could be adopted, and then adjusted in order to produce (say) a 20% discount on premiums for leaseholders.

Some consultees suggested alternative approaches to calculating relativity, or alternative valuation methods that would not require an assessment of relativity. They represented a wide departure from the conventional valuation approach, and as explained in Chapter 4, we cannot comment on whether or not they are the correct methodologies for assessing the market value of an asset.

As we explain in Chapter 4, it is not for us to comment on the level at which relativity or a no-Act deduction should be set.

Some consultees felt that any prescribed relativity should apply to all geographical areas but others considered there to be regional variations that should be accounted for. Several pointed out that relativity is dependent on the deferment rate (see paragraph 6.85 and Figure 27 above) and so, when considering whether relativity should be constant across all geographical areas, account should be taken of any likely regional differences in the deferment rate.

Consultees were generally in favour of the same body setting all three rates – including relativity and a no-Act deduction.

Responses relating to the frequency of review varied from supporting quarterly reviews (to take account of any economic events that might affect relativity) to relativity being fixed without review.

"In my view relativity should be prescribed – but this should be a once-only exercise after which the curve should be fixed for all time. There can never be any compelling evidence as to what relativity is or to show that whatever has been prescribed should be altered." (Philip Rainey QC, barrister)

A couple of consultees suggested that reviews of relativity should be in line with reviews for capitalisation and deferment rates. Five-yearly reviews was the most popular option, suggested by several consultees.

There was also a suggestion as to how the valuation assumptions, on which any prescribed relativity is based, could be altered.

"I would also tweak the valuation criteria to make it easier to prescribe and to increase fairness. For example I would add a “no scarcity” assumption i.e. an assumption that short leases were not “blighted” because most leases are now long. I would make the “no Act” assumption a true “no Act world” assumption – and add an assumption that there was no risk of an Act being introduced." (Philip Rainey QC, barrister)
Compatibility with A1P1 of prescribing rates

6.97 Counsel's advice on the compatibility with A1P1 of prescribing rates is as follows:

Valuation often involves the use of rates to determine capitalised or deferred capital sums, and for relativity. Identifying the appropriate rates can be difficult and contentious. The rate used can make a significant difference to the premium that will be paid. One of the options for reform introduced by the Law Commission is the idea of prescribing rates.

As the Law Commission has noted in my instructions, it is difficult to assess the compatibility with A1P1 of any prescribed rate without knowing what that rate might be and how it relates to the rate which would otherwise be applied by a valuer considering the individual attributes of a particular property. However, it seeks my advice on (a) whether prescribing rates would be compatible with A1P1, when the rate was intended to be a market rate, but prescription would necessarily mean that in some cases less than or more than a market rate may be obtained; and (b) where the rate is intentionally prescribed to be less than a market rate in order to produce a lower premium.

In relation to scenario (a), I consider that, at least in principle, prescribing a rate that is intended to be a market rate is likely to be compatible with A1P1. The concept of prescribing a rate is not of itself incompatible with A1P1. As the Strasbourg Court observed in Lithgow v UK, in the context of legislation which is intended to have a wide-reaching social and economic impact, it is justifiable to adopt a common formula which applies across the board, even if it is tempered with a degree of inbuilt inflexibility.

However, it would be important to ensure that the prescribed rate is not so inflexible that it does not in fact reflect the market rate in relation to particular categories of property or particular areas or particular lengths of lease. For example, in the case of deferment rates, it may be necessary to prescribe different deferment rates according to the location of the property or the length of the lease. I consider that if rates are to be prescribed, there would need to be a fair and transparent procedure for setting and adjusting the rates, to ensure the rates adequately reflect changing developments over time. It should also be possible for landlords or leaseholders to challenge the method by which the rates are prescribed.

I also note that ‘market value’ in the context of enfranchisement claims is an imprecise, flexible and in some cases artificial concept. Valuation is not an exact science, and in practice, professional valuers disagree about the appropriate rates for capitalisation, deferment and relativity. As there is no definitively ‘correct’ capitalisation rate, deferment rate or relativity, whilst enfranchisement premiums are meant to reflect the correct ‘market value’ for the landlord’s asset, the current valuation methodology can give rise to a range of possible outcomes in respect of the same property. Therefore, provided that the Government prescribes rates which result in premiums that are within the range of possible outcomes under the current law (or are even towards the lower end of that range of possible outcomes), it would be difficult to argue that such rates have not been prescribed at market levels. If such a scheme is developed, I consider that the risk of a successful A1P1 challenge to this aspect of the scheme is Medium Low to Low.

It is more difficult to advise in relation to scenario (b), in the absence of knowing the primary objective/s of the scheme, the identity of the leaseholders who would benefit.
from the scheme, or the level of the resulting premiums. A rate intentionally prescribed to be marginally less than a market rate, or not significantly below a market rate (or the range of values which can be described as market levels), would not ipso facto be incompatible with A1P1. But clearly, the further away from a market rate (or the range of possible outcomes reflecting market levels) that the rate is prescribed, the higher the risk of a finding that the scheme as a whole does not strike a fair balance, and imposes a disproportionate burden on landlords.

Conclusion: options for Government relating to prescription of rates

6.98 We have explained that the enfranchisement process could be made simpler, cheaper and more consistent if capitalisation rates, deferment rates and relativity (or the “no-Act deduction”) were prescribed. Government could decide to prescribe rates in order to:

(1) produce enfranchisement premiums that reflect the market value of the asset, by prescribing rates at market levels; or

(2) reduce enfranchisement premiums to below market value (to favour leaseholders), by prescribing rates at below market levels.

Prescription of rates at market levels

6.99 Prescription of rates aimed at market levels would not have the overall effect of reducing premiums, but it would have other valuable benefits for landlords and leaseholders.

6.100 We have explained the benefits of prescribing rates above. Prescription was supported by the majority of consultees. Opposition came largely from some landlords and many valuers, and we have explained – and responded to – their reasons for opposing prescription above. Our view is that the benefits of prescribing the three rates outweigh any disadvantages, and that those benefits would justify the cost and effort involved in prescribing rates.

(1) Prescription of rates would result in a simpler, clearer, more consistent and more certain valuation regime. Leaseholders would have certainty about what their enfranchisement premium would be (or at least the range into which the premium would fall).

(2) Under the current regime, it is impossible to find a conclusive “true” answer for any of the three rates because the choice of rates depends on arguments and opinions put forward by valuers. There is no single answer that is objectively and definitely demonstrable as being correct. Prescribing rates would introduce consistency that does not currently exist.

(3) The current regime gives rise to arbitrary results. Although prescribing rates would – like any prescribed threshold – introduce an element of inflexibility, the outcomes in many cases would not be as arbitrary as they can be at present. And although prescription would not lead to the perfect outcome in all cases, it would produce fairer and more consistent outcomes overall.

(4) The current regime encourages each side to do well at the other’s expense, rather than putting self-interest aside and endeavouring to arrive at a premium
that is a fair reflection of the market value. Prescribing rates would remove the impact of that incentive structure.

(5) Prescribing rates would reduce the scope for unfair results (primarily faced by leaseholders) caused by the inequality of arms, the bargaining counters, and the lack of bargaining power that currently exist.

(6) Prescribing rates would also reduce professional costs for leaseholders and landlords, reduce disputes, and reduce litigation.

Prescription of rates at below-market levels

6.101 Prescription of rates at below-market levels would deliver those same benefits, but would also reduce premiums for leaseholders. As explained in paragraph 3.35 and Figure 15 above, a difference of 1% to the deferment rate, to the capitalisation rate, and to relativity, each in favour of the leaseholder, could have a significant effect on premiums: see Figure 28 below.

Figure 28: effect on premiums of prescribing the deferment rate, capitalisation rate and relativity at (say) 1% below market levels

<table>
<thead>
<tr>
<th>House</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rates adopted</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current law: rates at market levels</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Option for reform: rates prescribed at 1% below market levels (in favour of leaseholder)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Valuation under:</td>
<td>Current law</td>
<td>Option for reform</td>
<td>Current law</td>
<td>Option for reform</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>6%</td>
<td>7%</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Deferment rate</td>
<td>4.75%</td>
<td>5.75%</td>
<td>4.75%</td>
<td>5.75%</td>
</tr>
<tr>
<td>Relativity</td>
<td>N/A</td>
<td>N/A</td>
<td>90.5%</td>
<td>91.5%</td>
</tr>
<tr>
<td><strong>Enfranchisement premiums</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Valuation under:</td>
<td>Current law</td>
<td>Option for reform</td>
<td>Current law</td>
<td>Option for reform</td>
</tr>
<tr>
<td>Part (1): term</td>
<td>£1,844</td>
<td>£1,528</td>
<td>£1,806</td>
<td>£1,511</td>
</tr>
<tr>
<td>Part (2): reversion</td>
<td>£2,303</td>
<td>£882</td>
<td>£7,349</td>
<td>£3,570</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
<td>£0</td>
<td>£0</td>
<td>£7,298</td>
<td>£8,085</td>
</tr>
<tr>
<td><strong>Total premium</strong></td>
<td>£4,147</td>
<td>£2,410</td>
<td>£16,453</td>
<td>£13,166</td>
</tr>
</tbody>
</table>
### Benefits of prescription of rates (at any level)
- Certainty and predictability
- Simplicity
- Consistency
- Removing unfair incentive structures
- Reduced scope for inequality of power, and litigation tactics, to influence the outcome
- Reducing costs, delays and litigation

### Benefits of prescription of rates (below market levels)
All of the benefits listed above, plus leaseholders would pay lower enfranchisement premiums

### Who would benefit?
- Prescription at market rates would have benefits for all leaseholders, regardless of the length of their lease, and some benefits for landlords.
- Prescription at below-market rates would benefit all leaseholders, regardless of the length of their lease.

### How should rates be set?

6.102 Many of the consultation responses regarding who should set rates involved suggestions that a representative body of experts be appointed. Given the very different views held by valuers about what the capitalisation rate, deferment rate and relativity should be (see paragraph 6.95 above), then any group that was truly representative of the different views that exist is unlikely to be able to reach agreement on the correct rates. Indeed, history has shown such attempts to be futile: see paragraph 6.95 above. Each member of such a body will have different ideas about what the rates should be. Those views could be based on different assessments of the market or on different valuation approaches, but equally they could be presented as being based on those things but in fact might reflect underlying interests or biases (either conscious or subconscious) of the experts involved. Some experts might even be lobbied by leaseholders or landlords or representative groups.

6.103 If decisions of the group were to be made by majority vote, then much would depend on the make-up of the group and the balance of power – for example, whether the majority of the group comprised experts whose views generally favoured landlords or leaseholders.

6.104 In any event, given the different views among professionals about the appropriate rates, even if a representative group were able to reach a collective decision about the appropriate rate, it would not necessarily mean that their decision would be “the right” answer.
6.105 In our view, therefore, there are limits to an approach which simply leaves rates to be set by a representative group. Some consultees suggested that the process for setting rates should involve some sort of decision-maker – such as Government, a judge, or the RICS. We think that a decision-maker is necessary in order for prescription of rates to succeed in practice. A decision-maker could still take advice from a representative body of experts, but ultimately would be able to balance the competing arguments and wider policy considerations in order to make a decision. Having a decision-maker would avoid the risk of a representative group ending in stalemate (as happened with the RICS relativity working group) or inappropriate majority rule (where the outcome could be an accidental outcome of the composition of the group). In our view, the best-placed decision-maker would be the Secretary of State or (in so far as the law is devolved to Wales) the Welsh Ministers, who should take advice from a representative body of experts.

6.106 The representative body might be able to agree on a compromise rate to recommend to the Secretary of State and/or Welsh Ministers. For example, based on consultees’ comments about the deferment rate (see paragraph 6.71 onwards above), a group might agree a compromise reflecting the *Sportelli* rate, perhaps with slight variation for properties outside London. If a representative body is not able to agree, they might instead be able to set out useful arguments in favour of their respective positions, which the Secretary of State and/or Welsh Ministers could take into account when deciding on the appropriate rate. For example, if the group cannot agree on the appropriate deferment rate, they could present to the Secretary of State and/or Welsh Ministers the arguments in favour of a deferment rate of (say) 3.5% and the arguments in favour of a deferment rate of (say) 9.75%.

6.107 If Government decides to prescribe rates, a similar approach could be adopted to the current process by which the personal injury discount rate is set: see Figure 29 below.

---

**Figure 29: Setting rates – an analogous case**

Personal injury claims usually result in lump sum awards of damages to claimants. These lump sums are, however, often intended to reflect future losses. Put simply, the court must determine what lump sum today should be awarded in respect of those future losses. In order to determine the appropriate lump sum, the courts use a “discount rate”: the rate of return to be expected from the investment of the lump sum awarded in respect of the future losses.

In some ways, this is similar to the valuation of “the term” in an enfranchisement premium, seeking to assess what capital sum today would reflect the landlord’s loss of future income.

The personal injury discount rate is reviewed by the Lord Chancellor every five years and, where appropriate, changed by statutory instrument. The first review (under a new statutory methodology) was concluded on 15 July 2019, and followed a Call for Evidence, which directly informed the Government Actuary’s advice to the Lord Chancellor. The Lord Chancellor is required to make a number of assumptions and to take a number of issues into account in

150 Created by s 10 of the Civil Liability Act 2018.
determining the appropriate rate (or rates, if different rates are thought to be appropriate for separate classes of case).^{151}

For subsequent reviews, the legislation sets out how an expert panel is to be constituted. The Government Actuary must be the chair of the panel, and the other four members must consist of an actuary, an investment manager, an economist and someone experienced in "consumer matters as relating to investments". The Lord Chancellor must decide whether the rate or rates should be maintained or changed, having received advice from the expert panel and having consulted the Treasury, and must give reasons for his or her decision. In terms of the application of the personal injury discount rate, the court can take into account a different rate of return in specific cases where a party to proceedings shows that it is more appropriate in that situation.^{152}

6.108 A similar approach could be adopted for prescribing rates in enfranchisement. The involvement of more independent experts, such as the Government Actuary, and the ultimate decision-making responsibility resting with the Secretary of State and/or Welsh Ministers, could go some way to addressing the concerns about the difficulties of a working group comprising different representatives having the task of agreeing the appropriate rates.

6.109 The approach that we suggest above could be used whether Government wished to prescribe rates at market levels or below market levels. The representative body would be able to advise on what it considered to be the market rates. The Secretary of State and/or Welsh Ministers would then decide what the rate (or rates) should be, and that decision could include an adjustment to the rate in order to set it at below-market levels – and therefore reduce premiums for leaseholders.

Different rates in different circumstances

6.110 Consultees gave a variety of views about whether different rates should be set in respect of different types of property, different types of lease (for example, different rent review mechanisms), and different areas of the country. It should be possible for the Secretary of State and/or Welsh Ministers to make such a decision, and to make that decision in the light of the advice of the representative body.

Reviewing prescribed rates

6.111 In terms of reviewing the rates, a popular suggestion amongst consultees was for a five-yearly review in respect of deferment and capitalisation rates. The prescription of relativity could also be considered on the same time frame, for example in order to reflect changes made to the deferment rate (see paragraph 6.85 and Figure 27 above about the link between the two). However, there were strong arguments by some consultees that, once set, relativity should not be changed again. As set out at paragraph 6.96(4) above, Philip Rainey QC argued that there can never be any compelling evidence as to what relativity is or to show that whatever has been prescribed should be altered. This is not the case in respect of deferment and capitalisation rates as market evidence is available as to what those rates are and how they might have changed over time. Counsel has advised that whether prescription of

---

^{151} Damages Act 1996, sch A1, para 4. Issues which the Lord Chancellor must take into account include, for example, the actual returns that are available to investors, which is one reason why a Call for Evidence was held before the first review.

^{152} Damages Act 1996, s A1(2).
rates is compatible with A1P1 would depend, at least in part, on whether the rates concerned were subject to appropriate reviews. These are all matters on which the Secretary of State and/or Welsh Ministers would need to make a decision.

Exceptions to prescribed rates

6.112 The personal injury discount rate is not entirely fixed: there is some flexibility to allow the court to depart from it in certain circumstances: see Figure 29 above. We note that Counsel’s advice is that compatibility with A1P1 could be affected, at least in part, by whether there was scope to argue that a prescribed rate was not appropriate in a given case: see paragraph 6.97 above. Such an approach would not be dissimilar from the current position with deferment rates which consultees described as being “effectively prescribed”, but where there is scope to argue for different rates in individual cases.

6.113 We think that significant difficulties would arise if the parties were able to argue that the prescribed rate should not apply in a given case. Many of the policy aims of prescription would be undone, and arguably prescribing rates would be pointless, if the prescribed rate could be adjusted in individual cases. We set out the problems that still exist under the current law with deferment rates, despite the fact that they are “effectively prescribed”, in paragraph 3.51 above. The problems arise not because there are necessarily many cases in which it is right to depart from the default rate, but rather because there is a risk of such departure and scope to argue the point. Those same problems would arise if there were fact-specific exceptions to prescribed capitalisation rates, deferment rates, and relativity. For example, it might become the default position for (say) landlords to argue that a different rate should be adopted, at which point the inequality of arms that exists, and the incentive structures that we describe above, could lead to leaseholders being compelled to agree to rates that are more favourable to the landlord.

6.114 In summary, a significant policy aim of prescribing rates is to provide certainty, and to level the playing field by allowing (predominantly) leaseholders to assert, with confidence, that the enfranchisement premium that they are required to pay is a fixed ascertainable sum. Giving landlords the ability to argue for a different rate – even if their argument in substance is wrong and would be rejected by the Tribunal – still creates uncertainty for leaseholders and exploits their (generally) weaker negotiating position. In addition, other benefits from prescription – such as reducing disputes, reducing litigation, and reducing professional costs – would also be undermined.

Option 7.

6.115 Capitalisation rates, deferment rates, and relativity (or a no-Act deduction) could all be prescribed by the Secretary of State and/or Welsh Ministers, after taking advice from a representative body of experts (which we refer to as “Sub-option 1”). Those rates could be prescribed:

(1) at market levels; or
(2) at below-market levels, in order to reduce premiums for leaseholders.
Can FHVP values be prescribed?

6.116 In Chapter 7 below, we discuss the possibility of an online calculator being available to set out what the enfranchisement premium in a given case will be. We say that the utility of such an online calculator would depend on the current variable inputs into an enfranchisement valuation being standardised. We conclude that prescribing the deferment and capitalisation rates, and relativity, would be pre-requisites to creating a useful online calculator. The FHVP value would, however, remain a variable input into the calculation, which would to some extent limit the potential usefulness of an online calculator since, until the FHVP is agreed or determined, a calculator could not provide a precise enfranchisement premium in a given case. If FHVP values were also prescribed, that difficulty would be overcome and an online calculator would always be able to provide a precise figure for an enfranchisement premium. But can FHVP values be prescribed?

6.117 We have concluded that capitalisation and deferment rates, and relativity, could be prescribed, despite the fact that (valuers argue) the rates vary between different properties, and each property might justify its own bespoke rate. We concluded that those rates could be standardised by prescription, and such an approach would be fair and reasonable in pursuit of the various policy objectives identified above. In a similar vein, it would in theory be possible to prescribe a range of FHVP values for different types of property: for example, data about average property prices could be obtained and then used to prescribe a series of notional values reflecting the different attributes of a property. A notional value could then be prescribed for (say) a 1-bedroom, a 2-bedroom, and a 3-bedroom flat in Devon.

6.118 On balance, however, we think that there is such scope for the FHVP value to vary between different properties that it is one input into the valuation calculation that should not be prescribed. Two different properties, even if they share certain attributes (such as number of bedrooms or location), can nevertheless vary very significantly in value. Value depends on a wide range of factors that are unique to the property, such as location, age, construction, period features, condition, size, number of bedrooms, bathrooms and reception rooms, and outside space. Whilst we think that the capitalisation and deferment rates, and relativity, could legitimately be standardised by being prescribed, we think that it would be artificial and arbitrary to seek to prescribe a notional FHVP value for different types of property.

SUB-OPTION (2): TREATMENT OF GROUND RENT

The significance of ground rents for landlords and leaseholders

6.119 Most residential long leases include a requirement for the leaseholder to pay an annual ground rent to the landlord. We explain the way in which the ground rent features in the valuation of an enfranchisement premium at paragraph 2.12 onwards above.

6.120 The ground rent can vary in amount from a peppercorn (essentially, nil) to many thousands of pounds. Sometimes the ground rent is fixed for the duration of the lease and sometimes it is subject to review at specific intervals. The rent review provisions in

153 We explain in para 9.97 below that data about average property prices is not currently collected at this level of detail.
a lease have an impact on the way in which the enfranchisement premium is calculated: see paragraph 2.17 above.

6.121 Landlords can regard freeholds as investments not only because of the possibility of capital growth, but also because of the regular, reliable income which ground rent provisions can offer. As we explained in paragraph 2.20 above, some ground rent income streams are more attractive to investors than others. Low, fixed ground rents are the least attractive to investors, whereas high ground rents subject to frequent reviews that keep pace with inflation are the most attractive. A ground rent that is linked to the Retail Price Index, or that doubles periodically, is an example of the type of income stream that investors might find particularly attractive. In recent times, investing in freehold properties let on leases containing relatively high ground rents which increase over time appears to have become popular as a means of satisfying increased demand for secure, long-term, inflation-proof returns. Such investments are especially attractive to insurance companies and institutional investors such as pension funds, and increased demand has driven up the market value of such property interests.

6.122 The very features that make these reliable income streams attractive to investors, however, can make them unattractive – and potentially financially disastrous – for the leaseholders who are obliged to pay them. A relatively high ground rent payable by a leaseholder of a relatively low-value property can be an unaffordable outgoing. In the case of doubling ground rents, the rent can quickly become onerous. The frequency of rent reviews, and the impact they can have, can turn what at first seems an affordable annual outgoing into a significant – and continually increasing – financial burden that can make a property impossible to mortgage and so virtually unsaleable. For example, Nationwide Building Society will not lend on new properties where the ground rent exceeds 0.1% of the property’s freehold value or where the ground rent doubles on future reviews. As explained at paragraph 3.52 above, we understand that it is now widely accepted that a ground rent above 0.1% of the property’s freehold value is “onerous”. The impact of these ground rents is often simply not understood by purchasers when they buy their home.

6.123 The obvious solution to the above difficulties for leaseholders with onerous ground rents is for those leaseholders to exercise their enfranchisement rights and seek to extend their leases or purchase the freeholds of their properties. As we have explained above, an enfranchisement claim extinguishes the landlord’s right to receive the ground rent under the lease. But the difficulty is that the enfranchising leaseholder must compensate the landlord for the loss of that income stream, and as explained in paragraphs 2.22 and 2.48 above, where an onerous ground rent is concerned, the cost of doing so will often have become prohibitive.

---

154 Some investors might say that they prefer ground rents that increase in line with the Retail Prices Index because they are less politically controversial. Ground rents that double reach extremely high levels, which are not affordable for ordinary leaseholders, and are particularly politically controversial. Doubling ground rents might therefore be seen by investors as more susceptible to potential Government intervention, and hence more risky than a moderate ground rent.

155 See https://www.nationwide-intermediary.co.uk/lending-criteria/new-build.
Possibility of ground rents continuing following a lease extension

6.124 Our discussion in this Report about the treatment of ground rent proceeds on the assumption that ground rents will always be reduced to a peppercorn following a lease extension claim. Accordingly, the landlord loses the full value of “the term”. In the Consultation Paper, however, we asked whether leaseholders should have the ability to elect to keep a ground rent obligation in their leases following a lease extension. That would have the effect of reducing enfranchisement premiums, since the leaseholder would not have to compensate the landlord for the value of the term. This could be especially useful for those leaseholders who have a relatively high ground rent and a long lease, for whom “the term” represents a significant portion of the enfranchisement premium. We will set out our recommendation on this possibility – and its interaction with any restriction on the treatment of ground rent in the premium calculation – in our second report to be published later this year.

The Consultation Paper

6.125 In the Consultation Paper, we explained that provision could be made in relation to the treatment of ground rent in the enfranchisement valuation process that would both simplify the calculation and reduce the overall premium – particularly for those leaseholders facing significant premiums as a result of onerous ground rents. We set out various ways in which that could be achieved.

(1) Limiting the number of ground rent reviews which are taken into account when capitalising the ground rent.

(2) Assuming that the ground rent is capped at (say) 0.1% of the freehold value of the property, and capitalising only that (capped) ground rent.

(3) Assuming that the ground rent only increases in line with the Retail Prices Index (“RPI”), and capitalising only that ground rent.

We also discussed the possibility of calculating the average ground rent for the remainder of the term, and capitalising that sum, but we noted that that approach would increase the premium.

6.126 In the case of approaches (2) and (3), where the lease provides for a future review to a percentage of the capital value or in line with RPI, a rent review could be assumed to take place on the valuation date, so that the rent that is capitalised for the period from the next rent review to the end of the lease is a percentage of the current capital value or takes account of the current RPI increase.

6.127 We gave a worked example of how these measures could operate and invited the views of consultees as to whether the treatment of ground rent in any valuation methodology should be restricted in any of those ways.

---

156 Enfranchisement CP, para 4.46.
157 Enfranchisement CP, paras 15.61 to 15.66.
158 Enfranchisement CP, Fig 22.
159 Enfranchisement CP, para 15.67.
Consultees’ views

6.128 Consultees’ responses to this question were mixed, with strong support both for and against some restriction on the treatment of ground rent in enfranchisement valuations. As may be expected, individual consultees – of whom many were leaseholders – were broadly in favour of a restriction, while most landlords were against it. These views reflect the fact that leaseholders will benefit from any restriction on rent in calculating the premium paid, while landlords will lose out by receiving a lower premium. Overall, however, a majority of consultees who provided substantive responses supported some form of restriction. The general arguments for and against reducing premiums – set out in Chapter 3 – underpinned many of the responses to our question about capping ground rents.

General comments in favour of a restriction on the treatment of ground rent

6.129 Positive views supporting restrictions on the treatment of ground rents in enfranchisement valuations were put forward by many leaseholders and their representative bodies, such as the Leasehold Knowledge Partnership and the National Leasehold Campaign, a couple of professional representative bodies, a couple of commercial freeholders (but only to a limited extent), several surveyors, a few legal professionals and some other consultees.

6.130 In addition to those who commented on one or other of the specific methods we suggested, there were many individuals who made more general comments in favour of ground rents being restricted in enfranchisement claims. Some said they approved of capping ground rents in some way, but many others thought that ground rents should be ignored altogether in the valuation calculation. Some also made comments going beyond enfranchisement, suggesting that all ground rents in existing leases should be reduced to a peppercorn, or should be subject to an upper limit of (say) £500 per annum, without enfranchisement being necessary. Some leaseholders expressed the view that ground rents are “money for nothing” for their landlords. They considered that they had already paid once for their homes and should not have to pay ground rents throughout their leases or additional premiums for enfranchisement.

6.131 We are aware of the concerns of many leaseholders about onerous ground rent provisions within their leases. We note that a number of calls have been made in recent years for intervention to reduce ground rents payable in existing leases, alongside Government’s announcement that ground rents in new leases should be no more than a peppercorn (that is, of no monetary value). It is not, however, within the scope of this project to reduce ground rents in leases outside the exercise of enfranchisement rights.

Arguments against a restriction on the treatment of ground rent

6.132 Those who disagreed with the restriction of ground rents in enfranchisement valuations included many commercial landlords, many valuers, and some lawyers.

---


161 See para 1.78.
6.133 Those who were against restriction of ground rents gave a variety of reasons. These included that the current approach was straightforward and workable and rarely led to Tribunal applications. But that view overlooks the fact that concerns with onerous ground rents largely relate to their impact on the cost of enfranchising, rather than difficulties in calculation (although there is plenty of scope to argue about the appropriate capitalisation rate: see Chapter 2 and 3). Some also felt that in Central London, leaseholders were well-advised and unlikely to have overlooked any onerous lease terms, such that there was no justification for any restriction. Similarly, some consultees considered that a change in approach would disadvantage freeholders who had assumed the current valuation methodology would continue and so had valued or acquired their portfolios on that basis. We consider it likely that developers creating onerous ground rent income streams, and the investors acquiring them, would have been aware of the consequences of onerous ground rents for the leaseholders and could have anticipated the significant public criticism that was likely to result.162 Both groups could have foreseen some type of intervention to regularise the situation and so took the risk of that happening.

Consultees’ views on particular suggestions

6.134 Our suggestions for how ground rent could be limited are set out at paragraph 6.125 above. Many consultees agreed with us that averaging was not a viable option as it took too much account of future ground rent levels, and therefore increased the premium. This is contrary to our Terms of Reference.

(1) Limiting the number of ground rent reviews which are taken into account

6.135 In the Consultation Paper, our worked example suggested taking into account just the first rent review. This approach could reduce premiums for leaseholders with increasing ground rents. Some consultees commented positively on this approach, although they offered different views on the number of rent reviews that should be taken into account. One suggested that only the first review be used in the case of fixed reviews, another suggested a review cut-off of 20 years, and a few proposed a review cut-off of 50 years. One individual said that RPI rents and rents doubling every 10 years or less should have a 50-year review cut-off. One consultee said that it is only in the rarefied world of leasehold reform that investors pretend that a rent review which is more than 20 years in the future is of any interest to them whatsoever.

(2) Assuming that the ground rent is capped at (say) 0.1% of the freehold value of the property

6.136 In the Consultation Paper, our worked example showed the effect of capping a doubling ground rent at 0.1% of the freehold value at the valuation date. This approach would reduce premiums for leaseholders who have ground rents that are already disproportionately high (compared to the value of their property) and those who have ground rents which are likely to become disproportionately high in the future when the rent is reviewed.

6.137 This suggestion attracted the most positive responses from consultees, though many consultees also argued against it.

162 See para 3.94 onwards.
“In the case of escalating ground rents a cap may be introduced so that any amount of ground rent above 0.1% of the capital value is ignored.” (Nesbitt and Co, surveyors)

“Ignoring the ground rent or any part of it would result in an inaccurate valuation of the landlord’s interest, would be unfair, and would no doubt be liable to legal challenge.” (Cerian Jones, surveyor)

6.138 We have already explained that ground rents above 0.1% of the freehold value are now generally regarded as onerous. Capping them at this level in the enfranchisement calculation would help leaseholders to buy them out at a more reasonable price and would also simplify the calculation of premiums based on such ground rents. Of the consultees who supported a restriction in principle, over half favoured a cap in enfranchisement valuations at 0.1% of the freehold value at the valuation date.

6.139 A wide range of consultees felt strongly about ten-year doubling ground rents and considered that a 0.1% cap would help remedy the problems faced by those leaseholders whose situations had not been rectified by their developers. But a 0.1% cap would not only help leaseholders with doubling ground rents; it would assist any leaseholder whose current ground rent is, or future ground rent after review may become, higher than 0.1% of the property value.

6.140 Not all consultees who were in favour of a 0.1% cap felt that it should apply on a national basis. Some professional advisers and several commercial landlords, all of whom were mostly active in central London, felt that it should not apply there. This was because they considered the central London residential market to be more sophisticated than elsewhere and thought lessees would have been well-advised regarding the effects of any onerous ground rent provisions prior to purchasing.

“It should be born in mind that leasehold properties in Prime Central London are commonly held by parties who had acquired such leases in the full knowledge any onerous terms of their leases, such as onerous or geared ground rent, or they would have received professional advice prior to exchange of contracts and would have adjusted their bids downwards accordingly. Such leaseholders operating in a sophisticated market would benefit from a windfall gain if on any subsequent enfranchisement the premium was calculated ignoring any onerous rents.” (Gerald Eve, surveyors)

(3) Assuming that the ground rent only increases in line with the Retail Prices Index

6.141 We suggested that rent reviews could be assumed to result in increases no higher than in line with RPI. This approach would help leaseholders with doubling ground rents, and whose landlords have not signed up to the industry pledge to convert such rent review provisions in their leases to RPI-based increases.163 This approach also attracted positive responses from some consultees including valuers, representative bodies, and commercial landlords. However, a few of those considered the approach took insufficient account of the inflation-proofing nature of the rent reviews and resulted in too low a capitalised sum for the ground rent. On balance, we therefore think that there is a risk that this approach may not simplify the valuation process or reduce costs. Moreover, while this approach would reduce premiums for leaseholders with doubling ground rents, it would not (by itself) assist leaseholders with ground rents that are

already high; it would therefore only be a partial solution to the problem of onerous ground rents in the valuation of enfranchisement premiums.

Assuming a review on the valuation date

6.142 Our suggestion that the rent be assumed to have been reviewed on the valuation date (see paragraph 6.126 above) attracted comments from a couple of valuers who confirmed it to be common practice.

Compatibility with A1P1 of a cap on ground rent in the enfranchisement valuation

6.143 As we go on to explain below, if Government wishes to limit the way in which high or onerous ground rents are taken into account in the enfranchisement valuation in order to reduce premiums for leaseholders, the best approach would be to cap the ground rent that can be taken into account. We have sought Counsel’s advice on the compatibility with A1P1 of a cap of 0.1% of the property’s value on the ground rent which may be taken into account on an enfranchisement valuation. Her advice is as follows.

In the scenario in which the leaseholder paid the same premium on the grant of the lease as he or she would have paid if there was no onerous ground rent liability, then in my view, the payment of onerous ground rent to the landlord is an undeserved windfall. I understand that ground rent generally bears no relation to the level of maintenance or the quality of service provided to leaseholders – that is the function of the service charge. Therefore, where leasehold properties are sold for the same price as their freehold equivalents, the ground rent simply represents a source of income for landlords, with little to justify it beyond the fact that it was agreed as a term of the lease. Where the ground rent exceeds 0.1% of the property’s value, it becomes disproportionate to the value of that property. For that same ground rent then to be factored into the calculation of the premium means that the landlord receives a further windfall when the leaseholder exercises his or her enfranchisement rights. In those circumstances, I consider that capping the ground rent at 0.1% of the property’s value represents a fair balance between the landlord’s contractual entitlement to receive some income and the rights of leaseholders, and is likely to be compatible with A1P1. The risk of a successful challenge to such a cap is likely to be Medium Low.

On the other hand, where the price paid for the leasehold property was reduced to reflect the onerous nature of the ground rent provisions, it may be harder to justify capping ground rent at 0.1% of the property’s value. The landlord would have a basis for arguing, in this scenario, that he or she has foregone capital in return for a guaranteed source of income over the life of the lease, and that the rent in excess of 0.1% of the property’s value is not in these circumstances a windfall. Nevertheless, as just one element of a scheme, it may still be possible for the Courts to find that capping ground rent at 0.1% of the property’s value represents a fair balance between the interests of landlords and those of leaseholders and wider society. Whether the Courts will do so will depend on whether the other elements of the scheme and the scheme as a whole can be said to impose a disproportionate burden on landlords. However, taking this element by itself, I consider that it is more likely than not that imposing such a cap in these circumstances would not be compliant with A1P1, or in other words, that the risk of a successful challenge to such a cap in these circumstances is Medium High.
Conclusion: options for Government

6.144 The consultation responses showed majority support for restricting the treatment of ground rent in enfranchisement calculations. The preferred option amongst consultees was by way of a cap limiting the ground rent which may be taken into account on a valuation to 0.1% of the freehold value of the property at the valuation date. The freehold value of the property already has to be assessed for the valuation, and so the current ground rent and the rent on review can simply be compared against that.

6.145 The effect of a cap such as this would be to reduce premiums payable in all enfranchisement claims where the ground rent is currently onerous, or is expected to become onerous following a rent review. In the case of leases that are not currently subject to onerous ground rents, and are not expected to be in the future, both the enfranchisement calculation and the premium will remain unchanged and so there will be no reduction in the overall premium payable.

6.146 We think that this approach may be a very desirable one for those leaseholders who are faced with onerous ground rents. It will not be the answer for all leaseholders in this position, as it would only help those who enfranchise. But it is a useful, targeted solution which would ensure that when someone enfranchises, the premium they pay is not increased by the presence of an onerous ground rent in their lease. Indeed, this approach might very well have the effect of enabling leaseholders who would not presently be able to afford to enfranchise – owing to such a ground rent – to do so. It is therefore also in line with our wider policy objective of increasing access to enfranchisement.

Benefits of capping ground rent in the valuation calculation

Reducing premiums for leaseholders with onerous ground rents.

Who would benefit?

Leaseholders who currently have onerous ground rents or whose ground rents may or will in the future (following review) become onerous, regardless of the length of their lease.

6.147 In our worked examples, a ground rent cap of 0.1% of the value of the property would not change the calculation of the enfranchisement premium in the case of House 1 or House 2, since the ground rent in those cases is not onerous. However, for House 3 and House 4, there would be a significant reduction in the premium: see Figure 30 below.
**Figure 30: effect on premiums of capping the treatment of ground rent at 0.1% of the freehold value of the property**

<table>
<thead>
<tr>
<th>House 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Details of existing lease</strong></td>
</tr>
<tr>
<td>Unexpired term</td>
</tr>
<tr>
<td>Ground rent</td>
</tr>
<tr>
<td>FHVP value</td>
</tr>
<tr>
<td><strong>Enfranchisement premium</strong></td>
</tr>
<tr>
<td>Valuation under:</td>
</tr>
<tr>
<td>Part (1): term</td>
</tr>
<tr>
<td>Part (2): reversion</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
</tr>
<tr>
<td>Total premium</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Details of existing lease</strong></td>
</tr>
<tr>
<td>Unexpired term</td>
</tr>
<tr>
<td>Ground rent</td>
</tr>
<tr>
<td>FHVP value</td>
</tr>
<tr>
<td><strong>Enfranchisement premium</strong></td>
</tr>
<tr>
<td>Valuation under:</td>
</tr>
<tr>
<td>Part (1): term</td>
</tr>
<tr>
<td>Part (2): reversion</td>
</tr>
<tr>
<td>Part (3): marriage value</td>
</tr>
<tr>
<td>Total premium</td>
</tr>
</tbody>
</table>
6.148 Counsel has advised that where a leaseholder paid the same premium on the grant of a lease\textsuperscript{164} as if there were no onerous ground rent liability within the lease, capping the rent taken into account on enfranchisement so as to exclude the onerous portion of it is likely to be compatible with A1P1. We understand this to have been the case in relation to most leases containing onerous ground rents. We therefore think that capping the ground rent taken into account on enfranchisement claims at 0.1% of the freehold value of the property is an appropriate one for Government to consider as a means of delivering its aim of reducing premiums.

6.149 That said, we are also aware that there will be certain long residential leases that qualify for enfranchisement rights, which contain a rent in excess of the 0.1% cap – in some cases perhaps considerably so – and for which the leaseholder either did not pay any premium or paid a premium which appropriately reflected the significant rent obligations under the lease. We have identified the following particular examples.

1. **Leases containing a “modern ground rent”**. When a lease extension of a house is granted under the 1967 Act, it takes effect as a new lease for a term 50 years longer than the remaining term under the existing lease of that house. No premium is payable on the grant of such a lease. Instead, what is known as a “modern ground rent” will apply during the extended term of the lease: see para 9.15. Modern ground rents are considerably higher than typical ground rents in modern leases because they essentially amount to a form of decapitalised lease extension premium. To put it another way, instead of paying an upfront premium to have an extension of their lease, the leaseholder of the house will be required, when the extended term commences, to make annual payments which together amount to the equivalent of an upfront premium.

2. **Specifically-negotiated lease arrangements**. Sometimes, a lease will be granted which appears for all intents and purposes to be a very typical long residential lease – save that it happens to have been granted for a nil or very low premium, because that is the agreement the parties have reached. In many of these cases, it would not be surprising to find a high or onerous ground rent liability within the lease. For example, a well-informed leaseholder may have negotiated a significant reduction in premium purely because of the inclusion of a high ground rent in the lease. We have also heard of occasional instances in which a leaseholder has offered to pay a higher-than-average ground rent in order to secure a reduction in the premium payable to purchase the lease. One consultee told us that they have known high-net-worth individuals purchasing properties in the Prime Central London market to make such requests where they are only interested in acquiring the property for a relatively short lease term (albeit still over 21 years) and will have little interest in enfranchising.

3. **“Market-rent leases”**. We have been told by some consultees that a small number of landlords have granted leases of residential properties in excess of 21 years but without requiring payment of a premium for the grant. Instead, the lease includes what would typically be described as a “market rent” rather than a “ground rent”. In other words, the leaseholders are obliged to pay a monthly rent

\textsuperscript{164} In this context, we use “premium” to refer to the price paid by the leaseholder to purchase the lease. See the Glossary.
much like the rack rent payable under an assured shorthold tenancy. The National Trust, for example, has explained that it has a number of properties let in this manner, such as houses which are run by the leaseholders as bed and breakfasts or pubs. Consultees have pointed out that some of the changes to qualifying criteria for enfranchisement rights which we provisionally proposed in the Consultation Paper might lead to these properties becoming subject to enfranchisement rights when they are not currently. We do not think that these properties becoming enfranchisable would be an especially significant concern on the current enfranchisement valuation methodology, because the premium which would be payable where a full market rent has to be accounted for is likely to make enfranchisement practically impossible for the leaseholder in most cases. For those for whom it would be possible, the landlord would receive significant compensation. But we are mindful that the position would be very different if Government were to introduce a cap on ground rents within enfranchisement valuations.

6.150 Where a leaseholder has paid a reduced premium to acquire their lease or lease extension, such as in the above scenarios, Counsel has advised that there is a Medium High risk of a cap which limits the rent that can be taken into account on an enfranchisement valuation being found incompatible with A1P1. In the case where a normal market premium has been paid, it is appropriate to impose a limit on ground rent because that income stream is purely that – an additional source of income for the landlord, amounting to a “windfall”. But where a lesser premium has been paid, it would be open to the landlord to argue that he or she has foregone compensation in the form of a capital payment on the grant of the lease in exchange for a guaranteed source of income over the life of the lease. He or she ought not, therefore, to be deprived of that compensation. To put it another way, in all three of the scenarios described above, the rent in excess of 0.1% of freehold value can hardly be described as a windfall for the landlord: it is an income stream instead of – rather than in addition to – a full premium.

6.151 It appears to us, therefore, that if Government were to take forward the idea of a 0.1% cap on ground rents in enfranchisement valuations, particular consideration would need to be given to these kinds of cases to ensure the landlord’s A1P1 rights are not infringed. We think that an appropriate solution would be to create an exception to the cap to cater for situations where it is thought the landlord has not been adequately compensated for the grant of the lease via the premium paid at the point of purchase. An exception would enable the full rent under the lease to be taken into account on an enfranchisement valuation, as is the way under the current law.

---

We have of course framed the cap as a cap on ground rents, designed to minimise the impact of those which are onerous. A “market rent” payable under a no-premium lease would not normally be considered onerous, and indeed would tend to be referred to simply as “rent” rather than as a ground rent. But “ground rent” is not a term of art and does not appear in the enfranchisement valuation provisions at present – in fact it is rent in general which must be factored into the calculation of the premium. We do not consider that it would be advisable to try to devise a means of distinguishing between “ground rents” and “market rents”. Thus, subject to what we suggest in para 6.151 below, the rent payable under this kind of lease would be subject to any cap in the same way as a normal ground rent.
6.152 The aim of an exception should be to capture all cases where no premium, or a premium which is indisputably less than market value, has been paid (either for the initial grant of a lease, or, where a lease has previously been extended, for the grant of the extended term). It would be necessary to consider how, exactly, an indisputably low premium could be identified, and how best to accommodate situations where one or other of the landlord and leaseholder – or perhaps both – are not the original parties to the lease. It would be necessary to ensure that the exception is not open to being used – or abused – by landlords arguing that any ground rent that is not onerous was reflected in some reduction in the premium. It may also be necessary to consider how a decision to cap ground rents for enfranchisement purposes would interact with Government’s intention to limit ground rents in future leases to a peppercorn (nil monetary value) – in particular, whether the proposed exceptions to the ground rent ban which Government has identified point to a need for any further exceptions to a cap on ground rents in enfranchisement valuations.

**Option 8.**

6.153 To reduce premiums for leaseholders with onerous ground rents, the level of ground rent that is taken into account in calculating enfranchisement premiums could be capped at 0.1% of the freehold value of the property (which we refer to as “Sub-option 2”).

6.154 An exception would be necessary for leases for which (a) no premium, or (b) a premium which is indisputably less than market value, has been paid.

**SUB-OPTION (3): DEVELOPMENT VALUE**

6.155 In some enfranchisement claims the premium may be increased (or the landlord may argue for it to be increased) in order to reflect the development potential of the premises being acquired. There is usually less potential to develop an individual flat or house as opposed to a block of flats. Consequently, development value is more often claimed to exist where leaseholders of flats seek to purchase the block than in other enfranchisement claims. A common example is the value in building further floors of flats on top of a block. This value would not be part of the value of any particular flat in the block, and would not, therefore, be included in the aggregated premiums in respect of the flats themselves. The additional value for potential development is therefore included separately in the calculation of enfranchisement premiums: see paragraph 2.56 onwards.

**The Consultation Paper**

6.156 In the Consultation Paper, we set out some of the difficulties which can arise regarding development value. The default position is that the leaseholders must pay the landlord in respect of any development value. That additional value will sometimes be

---

166 That is, what would be market value for the same lease but without the high ground rent provisions.

167 For example, the landlord may grant a lease at a reduced premium, but the lease is then subsequently assigned from Leaseholder A to Leaseholder B, with Leaseholder B paying a full premium to Leaseholder A.

168 Enfranchisement CP, para 15.87 onwards.
relatively easy to ascertain: for example, if the land being acquired already has planning permission for the construction of a new property. At the other extreme, however, there may be only a remote possibility that planning permission will be granted for an unspecified development at some future time. In that situation the landlord’s valuer will seek to obtain development value based on the best possible outcome for the landlord: the valuer may argue that planning permission will be easily obtained, that it would permit extensive development with low costs, and that it would generate high profits. The leaseholders’ valuer, by contrast, is likely to argue that those prospects are minimal in order to reduce any development value payable. As before, there will generally be compromise on the part of one side or the other, or the side with the stronger negotiating position may persuade the other to pay too much or accept too little rather than face the cost and uncertainty of a Tribunal hearing to resolve the dispute.

6.157 In some cases, the development value can be high relative to the remainder of the premium. In such cases, development value can either deter a claim or cause it to fail, because the leaseholders cannot afford, or do not want, to pay the development value. Agreements are, therefore, sometimes reached between landlords and leaseholders during negotiations for any development value to be retained by the landlord. Such an agreement can reduce the scope for arguments over value and also reduce the premium itself. But the landlord might not be willing to enter into such an agreement, instead requiring the leaseholder(s) to pay development value. And when such agreements are made, they can be difficult to implement under the current law as there is no specific mechanism for including or enforcing them within the enfranchisement legislation. Even approaches outside the scope of that legislation, and instead under the general law of property, are far from perfect. Restrictive covenants against development, for instance, are only binding under the general law if they benefit some identifiable land; it is often the case on enfranchisement that no such land is retained by the landlord.

6.158 There is currently no statutory solution to these issues. Sometimes, landlords and leaseholders will agree to include covenants in the new extended leases, or restrictions in the freehold transfer which prohibit any development, but these solutions may prove ineffective if a new freeholder then seeks their release. Alternatively, landlords may retain possession of the area in question, though, again, this is not always practically possible.

6.159 We therefore invited the views of consultees as to whether it should be possible for leaseholders to elect to take a type of restriction on development (specifically provided for in legislation), rather than pay development value as part of the initial enfranchisement claim.169 This election by the leaseholders would not require the agreement of the landlord, as is the case currently. If the leaseholders, following the acquisition of the freehold, wished to develop the premises, they would be able to negotiate a release from the restriction with the former landlord. The landlord would expect to be paid a premium in order to release the restriction; that premium would therefore be paid instead of the leaseholders having to pay development value at the time of the claim.

---

169 Enfranchisement CP, para 15.91.
Consultees’ views

6.160 Over half of the substantive responses to this question were in favour of leaseholders being able to elect to accept a restriction on development.

Consultees in favour of leaseholders being able to elect to take a restriction on development

6.161 Consultees in favour of providing for such an election included, notably, many leaseholders and a couple of bodies representing leaseholders, but also a broad spread of other categories of consultee.

6.162 Numerous consultees highlighted that being able to elect to accept a restriction on development would simplify enfranchisement claims and reduce premiums.

“... this seems a sensible proposal that could help leaseholders and make enfranchisement more affordable.” (National Leasehold Campaign, a leaseholder representative body)

“Providing a right for leaseholders to elect to accept a restriction on development would significantly reduce the cost of enfranchisement in cases where development value may arise. Often it is the leaseholders’ preference not to have the block extended or for any further development to be carried out, and so should not have to pay a price that reflects the value of a development that they have no intention of realising”. (Leasehold Forum, a body representing enfranchisement professionals)

“... this would help to reduce the cost of enfranchisement [and] significantly reduce litigation.” (The Wellcome Trust, charitable sector)

Several consultees said that it was not unusual for leaseholders to agree such a restriction with the landlord under the current law (despite the potential issues referred to above).

“In practice this often happens and it should be possible for claimants to elect to accept the restriction”. (Jennifer Ellis, a surveyor)

6.163 Some consultees in favour of enabling leaseholders to elect to take a restriction stressed that there would need to be a clearly prescribed mechanism to release the restriction.

“CILEx provisionally accepts this proposal, provided that it is possible to release the restriction at a later date where both parties consent.” (CILEx, a legal professional representative body)

“We agree with this proposal, which will simplify the valuation process in cases where there can be arguments about development potential, it would reduce enfranchisement premiums in such cases, and also reduce the scope for litigation. However, in any such scheme there must be a proper mechanism for (i) reserving the development value to the landlord and (ii) ensuring that the landlord is properly compensated if and when the reservation is released.” (British Property Federation)

6.164 Some consultees who agreed with the policy of enabling leaseholders to elect to restrict future development rather than pay development value thought that a statutory restriction would not be the best mechanism for achieving that policy. We discuss the alternative suggestions made below.
6.165 Other reasons given for enabling an election by leaseholders included that it would result in a reduced need for “white knight” investors to help finance the cost of a collective enfranchisement.

Consultees opposed to leaseholders being able to elect to take a restriction on development

6.166 A significant minority of consultees, including many commercial freeholders, were opposed to such an election. Some said that development should be encouraged rather than discouraged. They considered it preferable for the leaseholder(s) to obtain a freehold transfer clean of restrictions unless any are willingly agreed between both parties as part of their negotiations.

"On that basis the landlord would be secure in the knowledge that they have secured full value for the transfer, and the leaseholder would be secure in the knowledge that they have acquired an un-encumbered freehold“. (The Portman Estate, landlord)

We consider, however, that such an election itself would not discourage development. Rather, it simply ensures that development value is only paid if and when development is actually undertaken, rather than development value having to be paid at an earlier stage on a speculative basis.

6.167 A few consultees who were opposed to such an election foresaw practical and legal problems in putting it into practice.

"We do not believe it would be possible to incorporate a restriction which would last the length of the lease. The personal covenant between leaseholders and landlord outlined in [the Consultation Paper] would not hold for the lifetime of the lease as the parties will potentially change several times over the life of the lease". (Wallace Partnership Group Ltd, a commercial investor)

We consider that it would be possible to create a type of statutory restriction which would hold for the lifetime of a lease. But in any event, it is not necessarily the case that the restriction on development should last for the lifetime of the lease; it might be sufficient for it to last for (say) 10 or 20 years only. A development that takes place after a long period of time may be considered too speculative, at the time of the enfranchisement claim, for a premium to be required to be paid (for example, planning and other policies change over time and it is impossible to anticipate with any certainty what they might be far into the future). Further, we discuss alternative mechanisms for achieving the aim of allowing leaseholders to choose a restriction rather than to pay development value below.

6.168 Some consultees considered that it would be difficult to assess the freeholder’s compensation on release of the restriction.

(1) One consultee said that some leaseholders are already permitted to develop but it becomes financially viable only after enfranchising and acquiring a freehold or longer leasehold interest. In such circumstances they wondered how a restriction would apply and how compensation would be assessed. We consider that this can be dealt with within the enfranchisement valuation. The existing leaseholder would have the ability to develop but it would have a nil value as it would not be financially viable to exercise that ability. Following enfranchisement, a
development would be financially viable and the value of that could be assessed and a proportion paid subsequently, when the restriction is released.

(2) Another consultee asked whether the assessment would cover only development value existing at the date of the original claim for the freehold or all development value existing at the date of release.  

6.169 We agree that it would be necessary to be clear about the date at which development value is assessed. The assessment date could be the date of the enfranchisement claim (with provision for payment of interest over the intervening period), which would be likely to operate in favour of leaseholders. Alternatively, the assessment date could be the date of release of the restriction, which may lean in favour of landlords (and former landlords), as significant development opportunities may arise after the freehold transfer. Either date could be selected by Government.

6.170 Other consultees were concerned that landlords would have to continue to police such restrictions to monitor potential breaches. Where leaseholders subsequently wish to develop they would have to negotiate a release of the covenant or apply under the provisions of the Law of Property Act 1925 to have it lifted or amended. For those leaseholders the process would not be simplified, only delayed.

"Whereas this proposal would limit the premium payable to the benefit of the leaseholder by excluding from the premium any value attributable to development potential, it would not simplify the process in the long term. This is because as / when the former leaseholder wishes to undertake a development of the property in the future, which would be in breach of the restriction, it would be necessary for the former leaseholder to either negotiate with the former freeholder for the release of the covenant or to apply to the Upper Tribunal under the provisions of the Law of Property Act 1925 to have the restriction lifted or amended." (Gerald Eve LLP, surveyors)

This argument does not, however, address the fact that for those leaseholders who do not wish to develop, the enfranchisement process would be simplified and the price would be reduced.

6.171 A couple of consultees argued that a type of statutory restriction on development (a form of covenant in gross) would be an undesirable creation.

"… the covenant/restriction would have to exist in gross, and the benefit would have to be transmissible by the landlord. Therefore, it is logical to assume that a secondary market trading these restrictions would arise, which is not an attractive prospect." (Philip Rainey QC, barrister)

If it was considered desirable to prevent a secondary market arising it may be possible to prevent this by restricting the manner in which the benefit of these restrictions could be transferred (for example, by preventing their sale for value).

Alternative mechanisms to provide an election restricting development

6.172 In the Consultation Paper, we suggested that a restriction on development could be created by statute. Several consultees, including both those who agreed and those who

170 Damian Greenish, solicitor.
disagreed with the policy of allowing leaseholders to elect to take a restriction on future
development, made alternative suggestions about the appropriate mechanism to do so.

6.173 Those suggestions consisted of a type of personal agreement which would be created
between the leaseholders and the landlord, which would entitle the landlord to be paid
additional sums (or a proportion of the uplift in value of the property) in certain
circumstances, such as if planning permission to develop is granted. The agreement
would require protection (in order to be enforceable against future owners of the land)
通过 the use of a chain of covenants supported by a restriction on the land register.

“We believe that it should not be possible for leaseholders to accept a restriction on development
to prevent development value to be paid as part of an enfranchisement valuation. Alternatively,
we propose that a form of overage restriction entered on the freehold title at the point of
enfranchisement, capped at say, 20 years, would address this concern and avoid any dispute
over valuation at the point of enfranchisement. Otherwise, the freeholder is denied the
opportunity to take a legitimate profit and the suggestion that he should find other investment
opportunities to make a similar profit deprives him of a legitimate interest in the property.” (Long
Harbour and HomeGround, commercial investors)

“This could be achieved by using an overage clause in the sale. This would be similar to the
numerous sales that occur already when land is sold without planning permission but with a
degree of hope value. A restriction is included in the Transfer whereby the purchaser is obliged
to pay the seller a percentage, often 50%, of any uplift in value if planning permission is obtained
for development. This is usually time limited to 20 to 50 years. The same provision could be
included in the sale of a leasehold property, i.e. the purchasing leaseholder(s) would pay a price
excluding development value, but the purchase would be subject to a restriction on any
development unless the purchaser(s) pay the former freeholder 50% of any increase in value
due to development within 20 years of the date of sale.” (Caxtons Commercial Ltd, surveyors)

6.174 As we discuss below, we think that the use of a form of registrable personal covenant
between the leaseholder(s) and the landlord is attractive. If this approach were adopted,
leaseholders would not have to make any payment in respect of development value
unless that value is realised in some way: in other words, when they started developing
the land to make a profit, or, perhaps, when they sell the land or part of the land to a
third party at an uplift (to reflect that development potential). This means that if the
enfranchising leaseholder(s) benefit from development value at some time in the future,
then so will the previous landlord. If not, neither will benefit.

Compatibility with A1P1 of enabling leaseholders to elect to take a restriction on
development

6.175 We have sought Counsel’s advice on the compatibility with A1P1 of allowing
leaseholders to elect to create a restriction on future development in order to avoid
having to pay development value. Her advice is as follows.

In my view, enabling leaseholders to elect to take a restriction on development, so as
to avoid paying development value, is likely to be compatible with A1P1. This option
does not deprive landlords of an entitlement; it simply removes the conditions in which
an entitlement would arise. If the enfranchising leaseholders subsequently decide that
they want to develop, this option would ensure that landlords receive a portion of the
profit. Provided the landlords’ share of any subsequent profit is no less than the amount
the landlords would have received by way of development value at the date of the
Conclusion: options for Government

Benefits of enabling leaseholders to elect to take a restriction on development

Premiums would be reduced at the date of the freehold acquisition claim. If leaseholders subsequently decided that they wanted to develop, they would pay a portion of any profit received on a subsequent development to the landlord, rather than (as at present) having to pay development value in respect of a speculative future possibility of development.

Who would benefit?

Leaseholders of flats acquiring the freehold to their block, as they would not be required to pay the landlord an additional sum to reflect the potential to develop their properties. Leaseholders would no longer be required to negotiate with the landlord to create such a restriction; rather, they would be entitled to demand such a restriction be included.

Leaseholders and landlords, as disputes, negotiation and litigation about development value would be reduced.

6.176 In our view, the support from leaseholders and other consultees for an ability for leaseholders to elect to take a restriction on development, together with the clear benefits to leaseholders of a reduction in the premium payable (and a reduction in associated disputes), outweighs the disadvantages put forward by some other consultees. While we acknowledge there will be difficulties in putting this election into practice, we consider them to be surmountable, and insufficient to make such an election unworkable.

6.177 This approach would also satisfy the objective in our Terms of Reference to reduce enfranchisement premiums, whilst likely maintaining sufficient compensation for landlords. As explained above, whilst this option would not, as a default, involve the payment of development value by leaseholders to landlords, it would preserve that development value in the hands of those landlords, to be realised at a later date.

6.178 We agree with consultees, however, that a property right (created by statute) may not be the most appropriate means of putting an election into effect. Our conclusion is that, if Government wishes to enable leaseholders to elect to take a restriction on development, some form of registrable personal covenant would be a better alternative for achieving the objective. It would permit enfranchising leaseholders to avoid paying development value ahead of time but enable landlords to realise some value if development takes place in the future.
Option 9.

6.179 When exercising enfranchisement rights, and in order to reduce the premium payable where there is development value, leaseholders could be given the ability to elect to take a restriction on future development of the property (which we refer to as “Sub-option 3”).

SUB-OPTION (4): DIFFERENTIAL PRICING FOR DIFFERENT TYPES OF LEASEHOLDER

6.180 Enfranchisement rights were originally introduced in order to benefit owner-occupiers. In so far as our Terms of Reference require us to improve the position of leaseholders as consumers, and reduce premiums, they are aimed at improving the position of home-owners as opposed to leaseholders who own a lease as an investment.

The Consultation Paper

6.181 In Chapter 8 of the Consultation Paper, we considered whether it would be desirable for commercial investors to be excluded from any new enfranchisement regime and, if so, how this might be achieved. We formed the provisional view that it would be very difficult to achieve such a result, but asked consultees to share with us their views on this issue.

6.182 In Chapter 15 of the Consultation Paper we identified an alternative means of limiting the extent to which commercial investors can benefit from enfranchisement rights. We considered whether differential pricing should be introduced, so that commercial investors do not benefit from any reduction in the premium payable following reform of the valuation regime.

6.183 We suggested that distinguishing between different types of leaseholders when calculating premiums might be one means of ensuring the continued compliance of the enfranchisement regime with human rights obligations. In particular, we noted that the aim of enabling people to exercise enfranchisement rights in relation to their homes might justify a lower premium being paid to the landlord in those cases than in the case of an investor seeking to buy a lease extension or to buy the freehold of an investment property.

6.184 If a distinction between leaseholders is created, then a particular class of leaseholder could enjoy a more favourable basis of valuation. For example, different schemes of valuation (set out in Chapter 5) could apply to different classes of leaseholder, or if rates are prescribed (see Sub-option 1 above), then different rates could be prescribed for different classes of leaseholder.

6.185 Notwithstanding this potential advantage we have identified a number of arguments which lean against making such a distinction.

How can a distinction be drawn in practice?

6.186 The obvious difficulty is the same as that discussed at Chapter 8 of the Consultation Paper in relation to excluding commercial investors from enfranchisement rights.
altogether: how might one determine which leaseholders should qualify for a more favourable valuation?

6.187 Prior to the Commonhold and Leasehold Reform Act 2002 ("the 2002 Act"), there was a requirement for leaseholders to have occupied a property for a specified period before enfranchisement rights were available – usually referred to as the “residence test”. Some consultees suggested that the residence test could be re-introduced, in order to distinguish between different categories of leaseholder.

The Portman Estate, a landlord, expressed support for distinguishing between categories of leaseholder, but also said that doing so would create complexity and other difficulties. It argued that “the simplest approach would be to restore the residency test in the form that applied before its abolition by the 2002 Act, such as occupying the property as their own or principal home for the last three years or three years in the last ten.”

Some variations on the residence test from before 2002 were also suggested by consultees.

One anonymous consultee suggested that “if you have lived in the property for a length of time (say one or two consecutive years) ‘at any point in your ownership’ then you can get the enfranchisement entitlement of a first-time buyer”.

We discuss the problems to which that residence test gave rise (when it acted as a filter as to whether or not enfranchisement rights were available at all) in the Consultation Paper. The residence test was replaced with an ownership requirement in the 2002 Act, with occupation no longer a necessary component.

6.188 Given the problems with the residence test, we suggested in the Consultation Paper that a distinction could instead be made by adopting the approach of Stamp Duty Land Tax, which provides a discount for first-time buyers (of properties up to a certain value), or that of Capital Gains Tax, which provides relief in respect of private residences where a person has lived in a property as their only or main home (along with various other conditions).

6.189 Many consultees thought that those were the best tests to adopt in order to distinguish between owner-occupiers and others.

“Differentiation should be made to those exercising enfranchisement rights for the first time and in respect of his or her main home.” (Andrea McKie, a leaseholder)

“By reference to whether the leaseholder is exercising enfranchisement rights in respect of his or her only or main home.” (Nesbitt and Co, surveyors)

“In respect of the options… it is possible to distinguish between such leaseholders by reference to whether the leaseholder is exercising enfranchisement rights in respect of his/her only main home.” (Leasehold Forum, a body representing enfranchisement professionals)

6.190 Alternative suggestions were made by consultees as to how to distinguish between leaseholders. For example, it was suggested that commercial investors could be equated to corporate bodies and therefore a distinction made between natural and non-

171 Enfranchisement CP, para 8.185 onwards, and para 2.24.
natural persons. It is certainly the case that non-natural persons cannot be owner-occupiers. However, many natural persons can be investors. Accordingly, the distinction would be a blunt and inaccurate means to seek to identify owner-occupiers who are intended to benefit from a more favourable valuation basis.

Consultees’ views on differential pricing

6.191 Many consultees felt that making a distinction was a good idea in principle, but agreed that it would be difficult to do so in practice. This view was expressed both by those who favoured a distinction being drawn and those who did not.

Arguments in favour of differential pricing

6.192 Many of those who supported making a distinction felt it was a good idea for the reasons set out in the Consultation Paper.

6.193 Several consultees supported the distinction because it would mark a return to the original policy intention behind enfranchisement (which, until 2002, was limited to owner-occupiers), and others argued that it would allow the reduction of premiums for owner-occupiers to be justified under A1P1. Several leaseholders argued for a distinction to reflect what they considered to be a greater moral entitlement to a home in the case of owner-occupiers.

“I do believe commercial investors should pay more. I feel that a home should be for living in and those who wish to merely use it for their profit should pay a premium for this.” (Stephen Heslop, a leaseholder)

A distinction is “very sensible so that owner occupiers who are exercising enfranchisement for the first (and hopefully only time) are not punished in the same way that investors would be. This is someone’s home and they should not be expected to pay freehold investors a fortune to buy the freehold on their home.” (An anonymous leaseholder responding to our consultation)

“The original purpose of the legislation was to allow home owners to buy the freehold or extend the lease of their home. Removing the residence requirement has opened up enfranchisement and lease extension to investors. Ideally, we should return to the original purpose of the legislation and limit these rights to owner-occupiers only.” (Caxtons Commercial Ltd, surveyors)

Argument against differential pricing

6.194 On the other hand, many of the consultees who were against making a distinction thought that it would be difficult to implement, even though some considered a distinction a good idea in theory.

“Whilst desirable, I do not consider that this would be easily workable, and would be likely to give rise to considerable disagreement, and even litigation. Such a distinction might also distort the market, as the Commission have described.” (Howard de Walden Estates Limited, a landlord)

“The discussion is whether owner-occupiers should enjoy lower premiums than commercial investors, whether first-time claims should result in lower premiums and whether there should be lower premiums for a leaseholder’s main home. This is superficially attractive but may be difficult to apply in practice… On balance, although the intent behind this proposal is laudable, we feel that it is open to abuse and its policing would be difficult and contentious.” (Church Commissioners for England)
6.195 Even if the appropriate delimitation could be made, the following difficulties arise with any two-tier valuation scheme that distinguishes between different types of leaseholder.

6.196 First, it undoubtedly adds a layer of complexity to the law. It would be necessary on any enfranchisement claim to identify which valuation tier is applicable to that situation, which is likely to increase the scope for dispute.

“This will add a layer of complexity that is poorly understood and unlikely to be taken into account in property valuations, leading to more issues and even more reasons for consumers to avoid leasehold properties in totality.” (National Leasehold Campaign, a leaseholder representative body)

6.197 Second, the approach is arguably unfair on landlords. A large number of freeholders were against differential pricing because they felt that the premium should reflect market value no matter who the leaseholder was. From their point of view, the asset that they hold is the same, and it does not matter whether the leaseholder is an owner-occupier or not: the landlord will want to be compensated on the same basis. The argument has parallels to the equivalent argument by leaseholders that, from their point of view, the identity of their landlord is irrelevant when it comes to paying an enfranchisement premium: see paragraph 3.91 onwards above.

“The landlord is being compensated for their loss, not for the leaseholder’s gain.” (An anonymous consultee)

6.198 Third, the approach is arguably unfair on some leaseholders. A number of leaseholders were opposed in principle to making a distinction because they themselves are not owner-occupiers. They may own just one buy-to-let property to top up their pension, or might be inadvertent or even reluctant buy-to-let owners.

“I bought a flat to live in, lived in it for 8 years, then moved in to my now wife’s flat and let my flat out. I really like my old flat and would like to live there again. I would like to buy the freehold, extend the property and move in to it with the family. But perhaps I will instead buy the freehold, extend it and sell it, or let it out again, and perhaps move in to it later, or sell it later, or move into it and then sell it. I am not presently an owner occupier, but nor am I a ‘property investor’. I don’t think owner occupancy should be a factor in leasehold enfranchisement. It is certainly not relevant to the way I think about my flat, and if it is made a factor in the enfranchisement rules, I think it has the capacity for significant distortion.” (an anonymous leaseholder responding to our consultation)

“My wife bought a leasehold house 10 years ago before we were together. It contains a doubling ground rent clause which has meant that she cannot now sell the property so had to rent it out when we bought a home together. I know that many people have experienced the same issue on the estate … and have had to move for work/family reasons, with no way to sell the properties and not being able to afford two mortgages people have had no option but to rent the houses out.” (An anonymous leaseholder responding to our consultation)

6.199 Concerns were also raised that a distinction may increase the number of leaseholders unable to sell their leasehold property. CMS Cameron McKenna Nabarro Olswang LLP and the Property Litigation Association said that there is a market for investors who take short leases, which are often bought for cash because they are not easily mortgageable, and that there are sellers who rely on such investors to purchase their leasehold interests. Consequently, if these investors were to be treated differently under the new
regime, that could prejudice leaseholders in the market seeking to dispose of shorter leases and could result in such leasehold interests being unsaleable. However, those same consultees said that there is a positive impact to be achieved by differentiating between commercial and non-commercial investors if Government wishes to restrict overseas investors, especially within the London market, to make properties more affordable for domestic leaseholders.

6.200 Fourth, the existence of two different valuation methodologies might distort the market. In the Consultation Paper, we suggested that it may encourage a practice of landlords refusing to grant leases, or refusing consent to assign existing leases, to owner-occupiers, so as to ensure that leaseholders do not benefit from the lower valuation methodology. Alternatively, owner-occupiers might be expected to pay more than investors to purchase the same leasehold interest, to reflect the fact that the cost to them of exercising enfranchisement rights will be lower – in which case the current leaseholder receives a windfall gain. And even if investors do not themselves directly benefit from a more favourable valuation, they might realise (at least some of) the financial benefit of that more favourable valuation by selling their leasehold interest at a higher price to a prospective owner-occupier; the incoming owner-occupier could be expected to pay more for the lease in recognition of the fact that he or she would be able to realise the financial benefit of the more favourable valuation.

"An investor leaseholder who is selling to a future owner occupier (who would pay a lower enfranchisement premium) could make a windfall gain if they had themselves acquired the property from an investor." (Gerald Eve LLP, surveyors)

Compatibility with A1P1 of differential pricing for different types of leaseholder

6.201 Counsel has advised as follows:

Ultimately, whether the Government should limit the class of leaseholder eligible to benefit from leasehold enfranchisement rights or should provide differential pricing for different types of leaseholder will depend on the social policy objective being pursued and the level of premiums payable under the new scheme. If the primary aim of the reforms is to benefit ordinary homeowners and to redress perceived injustice suffered by them, then it is likely to be disproportionate and not rationally connected to the objective to bring within the class of leaseholder benefitting from enfranchisement reforms those who are not owner-occupiers. If commercial investors could rationally be brought within the scope of the scheme, the Government is likely to be required to introduce differential pricing if it wishes to set the premiums payable at a very low level, because such a low level of compensation is unlikely to be justified for those who are not owner-occupiers.

However, a two-tier valuation scheme is likely to have all of the defects identified by the Law Commission in paragraph 15.35 of its Consultation Paper. In particular, it is foreseeable that landlords will argue that a scheme under which premiums differ depending purely on the identity of the leaseholder is unfair and discriminatory.

If the Government’s primary aim is to streamline and simplify the leasehold enfranchisement system, then it is rational for the scheme to include all classes of leaseholder within its scope and to provide one method of calculating premiums. However, as this policy objective would not be as significant or important as eliminating...
injustice in the housing sector, the premiums should be set at a level that is closer to market value in order to strike a fair balance between the interests of landlords and those of leaseholders and general society.

**Conclusion: options for Government**

6.202 In conclusion, there are significant drawbacks to a regime that differentiates between different categories of leaseholders. Nevertheless, it would be possible to do so. If Government wishes to reduce premiums to a level that cannot be justified under A1P1 if it applied to all leaseholders, then it would be necessary for Government to create such a distinction.

**Benefits of differential pricing for different types of leaseholder**

Owner-occupiers would benefit from a lower enfranchisement premium.

The policy of reducing premiums for owner-occupiers may be easier to justify under A1P1.

**Who would benefit?**

Leaseholders who are owner-occupiers, regardless of the length of their lease.

6.203 If Government does decide to differentiate between different categories of leaseholder, there are various ways in which the distinction could be framed: see paragraph 6.186 onwards above. The best way to do that depends on Government’s objective in giving owner-occupiers a more favourable basis of valuation. If the intention is to return to the original intention of the enfranchisement legislation, then we think that the best way to do that is likely to be to use the residence test, which was familiar – albeit criticised – under the enfranchisement regime before the 2002 Act reforms. If the intention is to isolate particular categories of owner-occupiers for a more favourable valuation basis, then other tests – such as those used for Stamp Duty Land Tax or in capital gains tax legislation – could be adopted.

**Option 10.**

6.204 Despite its drawbacks, Government could reduce premiums for leaseholders who are owner-occupiers (and not for investors), in particular in order to justify the reduction under A1P1 (which we refer to as “Sub-option 4”).

**REFORM TO ELEMENTS THAT WOULD, BY THEMSELVES, INCREASE PREMIUMS**

6.205 We now turn to consider three possible sub-options for a revised valuation regime which would, by themselves, increase premiums for the leaseholders who fall into the category for whom they are relevant. At first sight, that would be contrary to our Terms of Reference. But we put forward these three sub-options only on the basis that they could be adopted in combination with other options for reform, so that premiums would be reduced overall, even though one aspect of the premium would (taken in isolation) increase.
The potential advantages of these three sub-options do not relate to the reduction of premiums. Rather, some consultees have argued that they would deliver other benefits, such as simplifying the enfranchisement process or removing inconsistencies in the current regime. In addition, these elements might have a role if taken as part of a global package of reforms, including when the new regime is tested for compatibility with A1P1. They were all options that we suggested in the Consultation Paper, and we set out consultees’ comments on them and our conclusions below.

Even if these sub-options are taken forward on the basis that they are pursued alongside other measures, so that the overall effect is to reduce premiums, there will be individual cases in which the consequence of the package of reforms adopted would be that the premium is increased from what would be payable under the current law. The extent to which these sub-options are pursued therefore depends on whether Government wishes its reforms to reduce premiums in every individual enfranchisement claim, or whether Government wishes to reduce premiums overall, even if the premium in some individual cases is increased.

This distinction is particularly significant for Sub-option 5 – removing the 80-year cut-off for marriage value. On its own, this sub-option would increase the premium paid when an enfranchisement right is exercised in relation to all leases with more than 80 years remaining (though leaseholders of flats with more than around 130 years remaining and who are extending their lease are unlikely to be affected because, in those cases, marriage value is unlikely to exist). That is a much more significant category of leases than those affected by the other sub-options that we consider in this section. Further, the increase in premium for those leaseholders is likely to be difficult, if not impossible, to offset by other measures.

(1) If Government wishes to reduce premiums in every individual enfranchisement claim, then Sub-option 5 (removing the 80-year cut-off for marriage value) should not be pursued. It would still be possible for Sub-options 6 (discount for leaseholders’ improvements) and 7 (discount for the risk of holding over) to be adopted provided that the increase in premiums for those leaseholders is offset by other reforms.

(2) If Government wishes to reduce premiums overall, even if individual cases might see increased premiums, then any of these three sub-options could be adopted, provided the increase in premiums is offset by other reforms. The result would be that in some (but not all) individual cases within the categories covered by these sub-options, premiums would increase. In relation to Sub-option 5, the increase in premiums could only (if at all) be offset by prescribing relativity in favour of leaseholders. Therefore, this sub-option should only be considered if Government decides to prescribe relativity in favour of leaseholders. We say more about that in paragraph 6.220 below.

We did not seek Counsel’s opinion about the compatibility with A1P1 of these options for reform since, on their own, they would increase premiums. Landlords would therefore have no basis for challenging them on A1P1 grounds.
6.210 In Chapter 3, we explained that the calculation of an enfranchisement premium includes 50% of the marriage value where the lease has an unexpired term of 80 years or less. Where the lease has more than 80 years still to run, no marriage value is payable, and the effect of the 80-year cut-off is that hope value (where relevant) is not payable either. The operation of the 80-year cut-off in respect of the three new schemes that we set out in Chapter 5 of this Report would therefore be as follows:

(1) under Scheme 1, no marriage value or hope value is payable in any event, so the 80-year cut-off would become redundant;

(2) under Scheme 2, hope value (but not marriage value) is payable, so the effect of the 80-year cut-off would be that no hope value is payable where the lease has more than 80 years left to run; and

(3) under Scheme 3, marriage value continues to be payable, so the effect of the 80-year cut-off would continue to be that no marriage value is payable where the lease has more than 80 years left to run.

6.211 The 80-year cut-off was introduced by the 2002 Act. It was introduced on the basis that the marriage value is likely to be very low, and can therefore be disregarded, when the unexpired term of the lease is more than 80 years. Many landlords and valuers disagree with that assumption.

The Consultation Paper

6.212 In the Consultation Paper, we said that there is a certain artificiality to the figure of 80 years, but ultimately it was a political decision in 2002 which favoured leaseholders by reducing premiums for leases over 80 years. At the same time, it has produced distortions in the market for leasehold properties. Without the cut-off, one would expect the value of a lease to decrease linearly, but the fact that marriage value becomes payable once there are 80 years remaining means that leases with around 85 years or less left to run will begin to drop dramatically in price.

6.213 We explained that if relativity or a no-Act deduction were prescribed, the time and expense of calculating marriage value would be reduced, and it could be possible to remove the 80-year cut-off. We asked for views on whether the 80-year cut-off should be removed, so that marriage value becomes payable (where it exists) for all lease lengths.172

Consultees’ views

Consultees in favour of removing the 80-year cut-off

6.214 Many consultees – mainly landlords, many valuers, and several lawyers – thought that the 80-year cut-off should be removed.173 They made the following points:

---

172 Enfranchisement CP, para 15.79(5).

173 Many leaseholders said they were in favour of removing the cut-off, but it was clear from the rest of their responses that they thought the effect would be to reduce premiums for leases with 80 years or less unexpired, rather than to increase them for leases with more than 80 years unexpired.
(1) the assumption that marriage value is insignificant when a lease has over 80 years remaining is mistaken; marriage value can be shown to exist beyond that point:

(a) for high value properties, marriage value beyond 80 years can be substantial; and

(b) certain value, which has little to do with lease length, can only be captured within marriage value.

“marriage value can arise, not just in consequence of the coalescence of the freehold and leasehold interests. For example, merger of a lease with the freehold may give rise to a development opportunity or a beneficial change of use which the leaseholder is unable to carry out under his lease. The consequential added value (which can be substantial and is realised immediately by the leaseholder) can only be captured as marriage value.” (Damian Greenish, solicitor)

(2) the 80-year cut-off point is arbitrary, and it is generally unfair to landlords to deprive them of marriage value if the lease exceeds 80 years.

“It is generally recognised that there is at least a 50% increase (and over 100% in some cases) in the premium payable for a lease with 80 years unexpired with no marriage value payable compared to the premium payable for the same property valued with 79 years unexpired, for which marriage value is included. As such the 80-year rule has been beneficial to leaseholders at the expense of landlords. Reversing the 80-year rule, as the Commission suggests, would restore the balance to the landlord.” (The Portman Estate, a landlord)

(3) that prescription of relativity would make it easier and less costly to calculate marriage value.

“By removing the 80-year threshold it would take pressure off leaseholders and make matters easier and cheaper for them.” (Long Harbour and HomeGround, commercial investors)

We would point out, however, that currently there are no costs associated with calculating marriage value for leaseholders with more than 80 years unexpired, for the simple reason that no marriage value is payable.

(4) Removing the cut-off would stop enfranchisement premiums increasing suddenly as the 80-year point is crossed. Currently leaseholders with more than 80 years remaining do not have to pay marriage value while those with 80 years or less remaining do. The artificial cliff edge that is created by the cut-off can result in an enfranchisement premium increasing significantly – and in some circumstances doubling\(^\text{174}\) – overnight.

“… it would remove from the market the (usually manufactured by third parties with financial interests) panic associated with leases dropping to the 80-year mark.” (Geraint Evans, a surveyor)

\(^{174}\) If the value of the term (ie the capitalised ground rent) is low.
(5) Removing the cut-off would improve the availability of mortgages for leaseholders.

“The cut-off more or less obliges tenants to make a claim before the term reduces below 80 years. This is not beneficial to the many tenants who would prefer not to be compelled to undertake this exercise at that point in time. The cut-off also now causes mortgage companies to look less favourably on leasehold interests that have less than 80 years unexpired, irrespective of the fact that 80 years is still an extremely long period.” (Paul Tayler Ltd, surveyors)

Consultees opposed to removing the 80-year cut-off

6.215 Opposition to removing the cut-off was expressed by leaseholders and their representative bodies, many surveyors, a legal professional, and some other consultees. The main argument raised was that removing the cut-off would increase premiums for leaseholders, and so was contrary to our Terms of Reference. Consultees also said that the cut-off was familiar, worked well in practice, and was relied upon by leaseholders and so its removal would be unfair.

“The market has become accustomed to the 80-year cut-off, although there is no real valuation justification for it.” (British Property Federation)

“To remove the cut off would increase the cost of lease extensions to prudent leaseholders who look to extend their leases before the 80-year cut-off. This would seem unfair as they bought with the knowledge of the existing position”. (Church & Co Chartered Accountants)

“Removing the 80-year cut-off could have a significant effect on the premiums for leaseholders with more than 80 years remaining, despite the prescribed relativity level, when those leaseholders have ‘done the right thing’ by ensuring their lease expiry stays comfortably above the 80-year mark. They should not be disadvantaged.” (An anonymous leaseholder responding to our consultation)

Consultees suggesting amending the 80-year cut-off

6.216 A few valuers and landlords suggested increasing the cut-off to 90, 100 or 125 years. One valuer, Jennifer Ellis, suggested reducing it to 70 years (if marriage value is to continue to be payable at all).

Conclusion: options for Government

6.217 We have noted above that each of the sub-options that we discuss in this section of the chapter would, on their own, increase the premium for all leaseholders affected by them. While in that respect removing the 80-year cut-off for marriage value sits alongside Sub-options 6 and 7, the potential adverse impact it would have on leaseholders is much more significant than the other sub-options.

(1) The category of leaseholders affected is significant. Removing the 80-year cut-off on its own would potentially increase the premium for all leaseholders whose leases have more than 80 years remaining (see paragraph 6.208 above).\footnote{Removing the 80-year cut-off would have no effect on leaseholders whose leases have 80 years or less left to run.}
The impact on those leaseholders is potentially significant, although it is dependent on which of our three schemes is taken forward by Government.

(a) If Scheme 1 is taken forward, then this sub-option falls away, as marriage value is not payable in Scheme 1.

(b) If Scheme 2 is adopted, then hope value would be payable in respect of a lease with more than 80 years left to run, when it is not currently payable. Hope value is less than marriage value, but the increase in premium is still potentially significant.

(c) If Scheme 3 is adopted, then marriage value would be payable in respect of a lease with more than 80 years left to run, when it is not currently payable. In House 2, for example, the marriage value payable by the leaseholder on a lease with 76 years left to run is £7,298. Marriage value on the same lease with (say) 81 years left to run would be lower than this sum, but still significant.\(^{176}\)

Removing the 80-year cut-off would directly reverse a measure introduced by the 2002 Act which benefits leaseholders.

6.218 We note the strong concern expressed by leaseholders at the 80-year cut-off being removed. We emphasise that, as our Terms of Reference require us to set out options that would reduce premiums, we do not put forward the removal of the 80-year cut-off, on its own, as an option for Government. It is an option that could be taken forward only as part of a package of reforms that would have the overall effect of reducing premiums. Further, we are careful in setting the parameters in which the 80-year cut-off for marriage value could be removed in a way which still ensures that premiums are reduced.

6.219 As we explained above, if Government wishes to ensure that enfranchisement premiums in every individual case are reduced, then the possibility of removing the 80-year cut-off should not be pursued.

6.220 If, by contrast, Government wishes to ensure that enfranchisement premiums are reduced overall, then it might be possible to remove the 80-year cut-off as part of a package of reforms, but only if relativity is prescribed in favour of leaseholders. Prescribing relativity in such a way as to offset the effect of removing the 80-year cut-off would call into question the desirability of removing the existing 80-year cut-off in the first place, since it would effectively achieve the same result; the approach would therefore involve an element of circularity.

6.221 In any event, if the option of removing the 80-year cut-off were to be pursued, further modelling would be required to ensure that relativity is prescribed at such a level to ensure that overall premiums are reduced, including for leaseholders with more than 80 years remaining, even though for some of these leaseholders there was an increase in the premium.

\(^{176}\) If House 2 had 81 years left to run, and marriage value was payable, the premium would be £1,816 for the term, £5,827 for the reversion, and £4,929 marriage value, giving a total premium of £12,572.
Benefits of removing the 80-year cut-off

For landlords, an arbitrary cut-off for the payment of marriage value would be removed. Distortion of the market would be avoided, and the artificial cliff edge faced by leaseholders approaching the 80-year point would be removed.

Who would benefit?

Landlords of leases with more than 80 years left to run, because removing the cut-off would increase premiums.

Leaseholders with more than 80 years left to run would not benefit unless this option is combined with other measures that would have the overall effect of reducing premiums. There would be no effect on leaseholders with 80 years or less left to run.

Option 11.

6.222 The 80-year cut-off should be retained, otherwise premiums will increase for some leaseholders. It might be possible, however, for Government to remove the cut-off as part of package of reforms that would reduce premiums overall (which we refer to as “Sub-option 5”).

SUB-OPTION (6): DISCOUNT FOR LEASEHOLDERS’ IMPROVEMENTS

6.223 The FHVP value of a property features in the valuation of two parts of the enfranchisement premium: the reversion (see paragraph 2.28 onwards above) and marriage value (see paragraph 2.40 onwards above). An increase in the value of a flat or house that is attributable to an improvement carried out by the leaseholder, or any predecessor in title, at his or her own expense can be discounted from that FHVP value, with the effect that the premium is reduced.177 This approach is aimed at preventing a leaseholder paying twice for the same thing: once when the works are carried out, and then when the (increased) freehold value of the property is assessed in the enfranchisement valuation.

The Consultation Paper

6.224 In the Consultation Paper we explained that this discount for leaseholders’ improvements can be the source of much dispute.

6.225 Arguments arise over a range of issues, not least regarding whether a particular item or alteration constitutes repairs (often mandated by the terms of the lease) or improvements, and whether value has actually been added to a property (instead of being merely cosmetic changes). Moreover, as we explored in Chapter 8 of the Consultation Paper, there is an ability for leaseholders of houses to chain together a

177 Enfranchisement CP, para 14.44.
series of long leases to claim a discount for ancient improvements, which can also lead to lengthy and expensive disagreements.\textsuperscript{178}

6.226 Disputes could be avoided, and professional and litigation costs reduced, if this discount were removed. We therefore invited the views of consultees as to whether a discount for leaseholders’ improvements should be retained in the enfranchisement valuation regime.\textsuperscript{179}

**Consultees’ views**

6.227 The vast majority of consultees who provided substantive responses considered that the discount should be retained. Some of the consultees who supported the retention of the discount, however, did so in a qualified way – with some suggesting alterations to the current law. These latter views are discussed below, following a general discussion of the views of consultees both for and against retaining the discount.

**Consultees in favour of retaining the discount**

6.228 Positive views were put forward by several bodies representing leaseholders, professional representative bodies, some lawyers, most valuers, many landlords, and a majority of individuals including leaseholders.

6.229 The main reason provided by consultees for retaining the discount mirrored our analysis in the Consultation Paper: it would be unfair for lessees to pay twice for improvements. Retaining the discount was said to be equitable to leaseholders.

“The freeholder should not gain from leaseholder improvements.” (Catherine Williams, a leaseholder)

“... it is unfair that a leaseholder has to pay a premium for their property, then has to pay ground rent and then has to pay a further premium to extend or enfranchise and that premium should not be increased because of their improvements to the property.” (The Conveyancing Association, a body representing legal professionals)

The fairness of this discount was said by a number of consultees to outweigh the desire to simplify the enfranchisement regime in this particular context.

“The original disregard has been watered down by Tribunals and there is some doubt in regard to improvements for which either no consent was granted, or the lessee cannot prove that consent was granted. Sometimes, consent is granted on the basis that the works of improvement are consideration for the landlord giving [consent]! If properties are not improved by the tenant

6.230 Furthermore, one valuer argued that it would be even fairer to improve and possibly expand the ambit of the discount.

“The freeholder should not gain from leaseholder improvements...” (Catherine Williams, a leaseholder)

6.226 We set out a full list of common categories of dispute in the Enfranchisement CP, para 14.98(4).

6.229 Enfranchisement CP, para 15.86.
over the decades, then many modest value properties would have no more than site value at
the end of the term. It is inequitable that the landlord is entitled to a reversionary value on the
assumption that there will be no deterioration or obsolescence in the value of the property
between the valuation date and the term date. That principle was recognised in the 1967 Act
where the landlord was held to own the site and the lessee was held to own the building. Rather
than merely retain the improvement disregard rule, if you have equity in mind, and you want to
make enfranchisement less expensive, the improvement disregard rule ought to be strengthened
not removed.” (Bruce Maunner-Taylor, a surveyor)

6.231 Many consultees argued that to remove the discount would run contrary to our Terms
of Reference, because, in cases to which the discount currently might apply, premiums
may increase.

“As the discount is of benefit to leaseholders, the object of this reform exercise, we propose that
it should be retained.” (Leasehold Advisory Service, (“LEASE”))

“Removing the [discount] would result in higher premiums for lessees which goes against the
aims of these reforms.” (Nesbitt & Co, surveyors)

6.232 One consultee, a trade association for UK real estate companies, wrote that some
degree of negotiation must be possible (and would be fair) in these cases.

“Inevitably the quantum of discount is a matter of negotiation and this may complicate
negotiations, but it has been an established principle of leasehold reform law and practice that
the freehold and leasehold values under discussion should reflect values net of improvem ents,
which is both equitable and serves to reduce the price payable.” (British Property Federation)

6.233 In addition, some consultees contended that disputes on this topic were in fact
comparatively rare.

“Few disputes over leaseholders’ improvements arise and therefore abolishing the discount
simply to avoid the rare dispute is unfair on a majority of leaseholders. Many leaseholders are
at pains to identify and list all the improvements carried out at their own cost so that they are not
penalised by having to pay the landlord a higher premium due to an enhanced value brought
about at their own expense.” (Leasehold Forum, a body representing enfranchisement
professionals)

Consultees opposed to retaining the discount

6.234 Consultees opposed to retaining this discount included several freeholders, some
valuers, and a few firms and individuals.

6.235 The most common reason given in support of removing the discount was that it is a
complicated area which causes lengthy and costly disputes.

“This discount should be removed. In the enfranchisement cases I deal with each year this issue
only rarely forms part of the calculation; it is subjective and therefore difficult to quantify and
actually only serves to complicate the process. If the government’s aim is to simplify
enfranchisement and make it quicker and easier, this is something that should not be retained.”
(Midland Valuations Limited, surveyors)

“We consider that the discount for leaseholders’ improvements should not be retained because
it will simplify the process and provide more certainty for leaseholders if the valuation is based
on the valuation of their property as is (on the assumption it has been maintained in accordance with the lease).” (Consensus Business Group, a commercial investor)

Some consultees referred specifically to areas of dispute which arise frequently – some of which we explore above and set out in the Consultation Paper. For instance, one consultee argued that many alterations are carried out to individual tastes and are likely to be changed again by future leaseholders.

“In a logical sense they should, otherwise they will be paying a premium to extend their lease based on a value of the flat that has increased as a result of the works they have done. However, in the real world [it is] very difficult to prove what are “improvements” as opposed to just maintenance or actually negative works e.g:

1. Replacing a kitchen – improvement? There was a kitchen, there is now a kitchen – it is different, but only in taste and style – this is maintenance.

2. replace hard wood sash windows with UPvC units – improvement? Many consider this to be vandalism and a destruction in value and cultural heritage.

In the real world there is practically no improvement to a flat that is not in reality a temporary change that will be restated 5 more times in its life. As such this should be ignored. Furthermore, in line with your remit, if you keep this concept you open up another angle for valuation disputes, which will increase costs to all involved.”

(Church & Co Chartered Accountants)

6.236 Some consultees thought that the arguments of fairness to leaseholders were perhaps overstated, and that removing the discount may create a fairer regime overall.

“On balance no; if a capped regime is put in place for landlords’ costs in order to encourage simplicity, we believe that the simplicity should be a two-way street, which would militate against adjustments in respect of leaseholder improvements.” (Maddox Capital Partners Limited, a commercial investor)

“I agree that landlords should not benefit twice, but many landlords do not know about improvements until the inspection takes place after the claim is made! So I would get rid of the discount.” (Jennifer Ellis, a surveyor)

6.237 Finally, it was contended that the discount is generally minor in terms of value.

“It is virtually always such a small figure that there is no point in retaining it. It is usually impossible to value the [vacant possession] value within that level of accuracy.” (Anthony Shamash, a commercial investor)

Consultees who expressed qualified support for retaining the discount

6.238 As we mention above, some consultees expressed support in principle for retaining a discount for leaseholders’ improvements, but argued that the current discount should be altered.

6.239 One of the key concerns of consultees was that, as currently set out in the 1967 Act, leaseholders are able to “chain” together past long leases, seeking to obtain a discount for improvements made many years ago. This was said to cause difficult disputes. The
suggestion was therefore made by several consultees that there should be a limit to how recent improvements must be in order to trigger the discount.\(^\text{180}\) One consultee argued that the improvements ought to have been made within the existing lease.

> “Yes, but only in respect of improvements under the existing lease. Section 3(3) of the 1967 Act and the ability to chain leases together to claim a disregard for ancient improvements should be abolished. I would also tighten up the wording, so that only real improvements, such as adding space or altering the layout, can be claimed.” (Philip Rainey QC, barrister)

Two consultees suggested an alternative: that the improvements should have been made within the existing lease or within the last 21 years (whichever is shorter).

> “This tends to be an issue more relevant to houses than to flats for the simple reason that it is often the ability to extend floor space or to develop (which is not generally available to flats) which gives rise to the most significant claims for discounts. In the case of the 1967 Act, section 3(3), particularly in the case of London Estates, causes notable problems where leaseholders can join together successive leases over many years to look for historic improvements, on occasions going back several centuries. At the very least therefore, improvements to be taken into account should be limited to those carried out during the term of the existing lease or within 21 years of the date of the claim (whichever is the shorter). That amendment would also remove the need to retain section 3(3).” (Damian Greenish, solicitor)

As can be seen from the responses quoted above, a further view expressed was that the discount should only apply where there have been improvements that involved the addition of space or an alteration to the layout of the property.

6.240 Separately, a number of consultees contended that, in the case of houses, there should be a valuation assumption that the property is in good repair to reflect the assumption that already applies in respect of flats. This would avoid, it was argued, leaseholders letting their property fall into disrepair in order to reduce the FHVP value and, therefore, the premium to exercise enfranchisement rights.

> “There should be no discount for leaseholder's improvements. However, in estimating the hypothetical value of the Virtual Freehold Price it should be assumed that the property is in good repair. It should not be open to the leaseholder to allow the property to go to rack and ruin in order to drive down the enfranchisement price.” (Tapestart Limited, a commercial investor)

6.241 Finally, some consultees commented on the actual mechanism employed for valuing the discount. The current statutory requirement is for the value of the improvements (rather than their cost) to be disregarded. This approach involves valuing the improved property and then deducting the value (not the cost) of the improvements, which is not straightforward in practice. In order to resolve this difficulty a few consultees suggested formalising a pragmatic approach currently adopted by valuers, which effectively disregards the improvements themselves rather than their value.

> “Our view is that it would be simpler and easier if there were instead an assumption that the property is unimproved.” (Church Commissioners for England)

---

\(^{180}\) Imposing such a limit would, as is explained by Philip Rainey QC and Damian Greenish in their responses, directly impact s 3(3) of the 1967 Act (the "chaining" provision referred to above). This is explored further below.
Conclusion: options for Government

<table>
<thead>
<tr>
<th>Benefits of removing the discount for leaseholders’ improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplifies the valuation regime, reducing the potential for disputes.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Who would benefit?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Landlords, because the effect of the discount is always to reduce premiums.</td>
</tr>
</tbody>
</table>

| Landlords and leaseholders (regardless of the length of their lease) would no longer incur costs when there are disputes about leaseholders’ improvements. |

6.242 We remain of the view that the discount as it is currently set out does lead to complexity in the valuation process. However, we appreciate that, in reality, disputes on this matter only arise in reality where a leaseholder decides it is in his or her interest to argue the point: usually to avoid paying twice for the same improvements. Along with most consultees, therefore, we consider that it would be inequitable to remove the discount for leaseholders’ improvements.

6.243 Indeed, removing the discount would, in cases where it would currently apply, increase premiums. As we discuss in paragraphs 6.205 to 6.207 above, we therefore only put forward the option of removing the discount if it is combined with other reforms as part of a package which reduces premiums overall.

6.244 Unless other reforms are going to reduce premiums, the discount for leaseholders’ improvements should be retained, and should apply where the leaseholder making a claim can demonstrate an uplift in value caused by improvements they (or their predecessors) have made. If the leaseholder does not consider it worth arguing over the discount, the issue will not arise in assessing the premium.

6.245 We do, however, suggest a technical change to the way in which the discount is assessed. We are in favour of simplifying and rewording the requirement so that it is the improvements themselves that are to be disregarded, rather than their value: a suggestion made by consultees and referred to above. As set out above, in practice, this is often the approach adopted by valuers and our suggestion would have the effect of aligning the legislation with that approach. The assumption would be that the layout, extent and condition of the property are as at the date the lease was granted, with the leaseholder having complied with the repairing obligations, but not having altered, extended or refurbished the property.

6.246 Furthermore, there are a number of changes which could be made to the discount, which may reduce the scope for disputes. Examples of these changes, raised by consultees, include the following.

1. Only applying the discount to improvements made within a certain time limit, to prevent arguments about improvements made many decades ago, and perhaps by predecessors. Various consultees suggested imposing a period of 21 years or the existing lease term, whichever is the shorter.

2. Only applying the discount to improvements which added space or altered the layout of the property, to prevent arguments about merely cosmetic changes.
It may be argued that such changes would be fairer to landlords, who may otherwise be put to significant cost arguing about improvements (at a leaseholder’s election), for instance, from many decades previously. However, these changes are likely to limit the applicability of the discount, especially as they would be applied across the board, to leaseholders of both flats and houses. Therefore, in some cases, any such alterations are likely to increase premiums.

6.247 As we mention above, we asked a related question to this one in Chapter 8 of the Consultation Paper concerning the “chaining” provisions in the 1967 Act. These provisions enable a leaseholder of a house to seek a discount for improvements made during a previous long lease. Whilst the consultation questions from Chapter 8 of the Consultation Paper are not considered in this Report, it is important to note the interplay between that topic and the one discussed here. The policy chosen by Government with respect to whether to retain the discount for leaseholders’ improvements, and if so whether to alter its applicability, will impact on whether and, if so, in what form, the chaining provisions are retained. For instance, if it is decided that leaseholders’ improvements should only be relevant in terms of a discount where they were made within the existing lease, the chaining provision181 would be rendered obsolete.

<table>
<thead>
<tr>
<th>Option 12.</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.248 The discount for leaseholders' improvements should be retained (and applied at the election of the leaseholder where appropriate), otherwise premiums will increase for some leaseholders. Government could, however, remove or limit the discount in order to reduce disputes, as part of a package of reforms that would reduce premiums overall (which we refer to as “Sub-option 6”).</td>
</tr>
<tr>
<td>6.249 The discount could be simplified so that the improvements themselves are disregarded, rather than their value.</td>
</tr>
</tbody>
</table>

**SUB-OPTION (7): DISCOUNT FOR THE RISK OF HOLDING OVER**

6.250 When a long lease comes to an end, certain statutes make provision for the leaseholder to have continuing security of tenure: to “hold over”. Usually, this security of tenure involves the leaseholder being able to remain in occupation under a Rent Act tenancy, or under an assured tenancy at a market rent.182 The right of a leaseholder to hold over is, except in claims under the original valuation basis, currently reflected in the enfranchisement valuation by way of a discount to the premium (as the freehold is considered to be reduced in value by the right to security of tenure).

**Current position**

6.251 In the Consultation Paper, we explained some of the problems that arise with respect to this discount for holding over. A particular example is that for claims over houses it is

---

181 In s 3(3) of the 1967 Act.
182 Part I of the Landlord and Tenant Act 1954 and sch 10 to the Local Government and Housing Act 1989 respectively, depending on when the long lease was granted and when it expires or expired.
the landlord who is required to prove that there is no right for the leaseholder to hold over in order to avoid the discount being applied: in contrast, for claims over flats, it falls to the leaseholder to prove that there is a risk that he or she will hold over. Furthermore, the level of discount to be applied has caused difficulty, which has yet to be resolved by court or Tribunal decision.183

6.252 As a result, we invited the views of consultees as to whether the possible right to hold over at the end of a long lease should be disregarded on an enfranchisement valuation: in other words, we asked whether the discount should be removed.184

Consultees’ views

6.253 The majority of substantive responses were in favour of retaining a discount for the possible right to hold over at the end of a long lease. However, consultees’ views were finely balanced, with many arguing for retaining the discount, or for retaining it in a limited way.

Consultees in favour of retaining the discount

6.254 Consultees wishing to retain the discount included bodies representing leaseholders and enfranchisement professionals, one landlord, and many valuers. The most common reason given was that removing the discount would increase premiums, even if only for a small subsection of leaseholders.

“We agree that the removal of the right to hold over will make little difference to most valuations. However, it will significantly impact valuations where there are few years remaining on the lease and should therefore be retained in order to be equitable to all parties to the lease.” (Wallace Partnership Group Limited, a commercial investor)

“This does not need to be disregarded by statute as it rarely applies in any event. However, in certain situations there may be good reason to apply the discount and applying the disregard would unfairly disadvantage the lessee.” (Nesbitt and Co, surveyors)

6.255 Numerous valuers argued that the right to hold over is a reality, which has measurable effects on values, and so it should be factored into the enfranchisement calculation.

“The right to hold over should be taken into account, so as to reflect the true-life situation.” (Fanshawe White, surveyors)

“From my experience, where a tenant did hold over after the expiry of a long lease, the resulting procedure for the landlord and the discounted rent due to condition was a considerable disadvantage. Therefore, where there is a real prospect of holding over, I believe there should be a discount.” (Prosper Marr-Johnson, a surveyor)

183 For a more complete discussion of these and other issues, see Enfranchisement CP, paras 14.40 to 14.43, and 14.98(3).
184 Enfranchisement CP, para 15.83.
6.256 LEASE contended that the discount demonstrates a preference for owner-occupier leaseholders.

"It would… demonstrate the preferential treatment given to those who are owner-occupiers over those who are commercial investors."

Consultees in favour of retaining the discount in a limited way

6.257 A number of consultees expressed support for the discount to reflect the risk of the leaseholder holding over, but only in a limited sense.

6.258 The predominant view expressed by these consultees was that the discount should only be applicable to leases which are very close to expiry, with several consultees suggesting that the lease should have less than five years remaining.

"We do not consider there is a serious risk of holding over in any but the very shortest of leases and we do not think the market reflects this either. We therefore consider that such a risk should be disregarded except in cases of very short lease (sub five years), and where there is a realistic possibly of an Assured Tenancy at reversion. The time and expense in arguing the point rarely equals the amount of the discount." (The Eyre Estate, a landlord, and the British Property Federation)

Other consultees argued that the relevant period should be longer.

"At the moment, for the main, discounts are only claimed and granted where the lease qualifies and is sub-10 years. Our view is that this should continue and be prescribed at a rate of, say, 5%." (Church Commissioners for England)

"This is generally only taken into account when there is a short unexpired term remaining on the lease, perhaps around 20 years or less. One is only assessing the risk of the tenant holding over upon expiry rather than the actuality. Usually a property subject to an assured tenancy is valued at circa 95% of vacant possession value, so the discount for an assured tenant in situ is 5%. Therefore, making a deduction of 2.5% to reflect the risk of that prospect would seem to be an appropriate adjustment, in the case of a lease with 20 years or less remaining on the lease at date of claim." (Cerian Jones, a surveyor)

6.259 Moreover, as suggested in the Church Commissioners’ response above, some consultees argued that the discount should be prescribed in order to reduce disputes.

"The discount should be prescribed, and should be low." (Philip Rainey QC, barrister)

"It would… simplify the valuation if set parameters for unexpired lease term were established to include the amount of discount and number of years remaining." (The Wellcome Trust, charitable sector)

Consultees opposed to retaining the discount

6.260 Consultees against retaining the discount for holding over included, among others, some freeholders, and many valuers.

6.261 One of the primary reasons given for removing the discount was along the lines that we expressed in the Consultation Paper. In most situations, as we explain above, the right of a leaseholder to hold over will be under an assured tenancy at a market rent. Where this is the case, the discount should arguably be nil (or minimal).
“The right to hold over should only be considered in the instances of the very shortest leases and even then does the adjustment made have a very small effect on the premium. It is an added complication which hinders the government's aim of making enfranchisement easier and more simple.” (Midland Valuations Limited, surveyors)

“I agree that this right should be disregarded as I do not consider that the right gives rise to a notable detrimental impact on the value of the freeholder's interest.” (Howard de Walden Estates Limited, a landlord)

Church & Co Chartered Accountants suggested that the right to hold over is in fact beneficial to the freeholder, rather than detrimental, as it is generally thought to be.

“1. As the tenant will move to an assured tenancy at an open market rent, and by their nature freeholders are investors, this is a slightly better deal for the investor than having to go and find their own tenant.

2. Due to [statutory re-development rights under] section 61 [of the 1993 Act] rights a freeholder is anyway able to gain possession at this date or earlier (where the lease has been extended) to allow for, often desperately needed, re-development.

3. The only reason the right exists is due to legislation, that did not exist even 55 years ago. As such to impose this new legislation effect on values (if there is one) would be wrong.”

6.262 Another consultee argued that there was an inherent contradiction in the discount.

“… this is a double counted discount – the prospects of a tenant holding over are not only unlikely but contradicted by the very act of extending the lease.” (The Dulwich Estate, Dame Alice Owen’s Foundation, and The Charity of Richard Cloudesley, charitable sector)

6.263 Furthermore, some consultees contended that the right to hold over is exercised very infrequently.

“The right to hold over should [be] ignored - it is not a benefit most lessees have any idea exists simply put up as a way of reducing prices. Most owner occupiers would not consider converting to being a renting tenant paying a market rent [on] letting the lease expire.” (Jennifer Ellis, a surveyor)

6.264 Other consultees argued, in line with some of the criticisms we laid out in the Consultation Paper, that calculating the discount is generally arbitrary, complex to apply, and a source of disputes.

“Disregarding the possible right to hold over at the end of tenancy, would simplify the process. The legislation requires carrying out a test on five points, all of which must be fulfilled in order to apply a discount, which in most cases causes further disputes.” (Anna Symonowicz, a surveyor)
Conclusion: options for Government

Benefits of removing the discount for the risk of holding over

Simplifies the valuation regime, and reduces disputes about an element of the valuation scheme which generally has only a minor effect on the premium.

Who would benefit?

Landlords, because the effect of the discount is always to reduce premiums.

Landlords and leaseholders (regardless of the length of their lease) would no longer incur costs when there are disputes about the discount for holding over.

6.265 A majority of consultees were in favour of disregarding this possible right to hold over, predominantly for the purposes of simplifying the valuation regime and reducing disputes. It was also argued that the effect of the discount on premiums is relatively small, and that it is applied fairly rarely.

6.266 However, removing the discount for holding over would, in reality, have the effect of increasing premiums – even if only for a small subsection of leaseholders with very short unexpired terms on their leases. We discuss this further in paragraphs 6.205 to 6.207 above. As a starting point, therefore, we are again of the view that the discount should be retained. We put forward the option of removing the discount only if such a move is combined with other reforms as part of a package which reduces enfranchisement premiums overall.

6.267 As with the discount for leaseholders’ improvements, consultees suggested various ways in which the discount for holding over might be improved, as we consider above. Most attractive among these were the ideas to limit the discount to leases with short unexpired terms (for instance, five or ten years), and to prescribe the discount as a percentage (for example, 5%). However, whilst these changes may reduce the scope for disputes, we are again aware of the possibility that they would have the effect of increasing premiums. We therefore, again, put forward these options only if they are combined with other reforms which reduce premiums overall.

Option 13.

6.268 The discount for holding over should be retained (and applied at the election of the leaseholder where appropriate), otherwise premiums will increase for some leaseholders. Government could, however, remove, limit or prescribe the discount in order to reduce disputes, as part of a package of reforms that would reduce premiums overall (which we refer to as “Sub-option 7”).

CONCLUSION

6.269 Having set out seven possible sub-options for a new valuation regime, we now turn in Chapter 7 to consider the potential role of an online calculator. Then, in Chapter 8, we explain how the sub-options in this chapter could fit within the three overall valuation schemes that we put forward in Chapter 5.
Chapter 7: Working towards an online calculator

INTRODUCTION

7.1 Having set out the three alternative new schemes (in Chapter 5), and various sub-options for such a new scheme (in Chapter 6), we now turn to consider the potential role of an online calculator in ascertaining enfranchisement premiums. Depending on which sub-options are adopted from Chapter 6, it would be possible for an online calculator to be made available which would tell leaseholders and landlords – in certain circumstances – what the enfranchisement premium is. In this chapter, we explain how such an online calculator could operate.

THE BENEFITS OF AN ONLINE CALCULATOR

7.2 In the Consultation Paper, we referred to a number of online calculators for enfranchisement premiums that are currently available in the market. These calculators can be useful for leaseholders who want to estimate what their enfranchisement premium might be. Their main limitation is that they can only generate figures based on estimates of what the applicable rates might be. The ultimate enfranchisement premium might, therefore, be very different from the indicative premium generated by these calculators. That is no criticism of the calculators themselves. It is a consequence of the different rates being variable: see Chapter 2.

7.3 The benefits of an online calculator would depend on the extent to which it was determinative in stating what the enfranchisement premium in a given case will be. We discuss below how determinative an online calculator could be. When commenting on the possibility of an online calculator, consultees tended to assume that it would provide the exact figure for the enfranchisement premium in a given case.

7.4 There are five main potential benefits to an online calculator. We conclude below that these benefits could only be achieved meaningfully if rates were prescribed (see Sub-option 1 in Chapter 6).

7.5 First and foremost, if an online calculator could provide a determinative figure for the premium, the principal benefit would be providing certainty for leaseholders and landlords as to what the premium will be. We discuss the problems associated with the current uncertainty about enfranchisement premiums in Chapter 3. The parties would have certainty about the premium at a very early stage in the process, rather than (as at present) having to wait for the negotiations between their valuers to conclude, or even wait for a Tribunal determination, before they know how much the enfranchisement claim will cost – and in some cases therefore before they know whether or not they can actually afford to pursue the claim. CILEx (a legal professional representative body) commented that an online calculator “would be a particularly useful tool for conveyancers who are usually the first to be contacted on valuation matters despite the fact that valuations lie outside their remit”.

185 Enfranchisement CP, para 15.104 and Fig 31.
7.6 Second, an online calculator would remove complexity for the parties and for everyone involved in the enfranchisement process. It does not matter how complicated the calculation itself is. As long as the parties know what figures to input into the calculator, all the calculations can be done “behind the scenes”. The calculator could provide the user with guidance as to what figures and details need to be inserted into the calculator and how a leaseholder could ascertain those figures and details. So, for example, to calculate the value of “the term”, it is necessary to establish the capitalisation rate, then ascertain the “years purchase” figure, then multiply that by the ground rent in order to generate the value (see paragraph 2.16 above). But if an online calculator is available, and if rates are prescribed, it would be a matter of simply inserting the ground rent into the calculator in order to generate the valuation of the term. The user would not need to know the process involved in converting that ground rent into a valuation figure (so they would not need to know what a capitalisation rate or a “years purchase” figure is, nor would they need to know what that rate or figure is in their case). The calculator could provide the user with guidance as to how they can find out what the ground rent is.

7.7 Third, an online calculator would reduce professional costs for leaseholders and landlords. There would be no need, or less need, to obtain and pay for professional advice from valuers. Since leaseholders currently have to pay their own legal and valuation costs, as well as contribute towards their landlords’ legal and valuation costs, it would be leaseholders who would enjoy the greatest benefit from reducing professional costs in the enfranchisement process.

7.8 Fourth, an online calculator could reduce the inequality of arms that currently often exists between leaseholders and landlords and the potential for uncertainty to be used as a bargaining counter: see Chapter 3. By acting as an external determiner of the premium, the online calculator could reduce the scope for positioning in negotiations over the premium.

7.9 Fifth, an online calculator could reduce disputes between the parties and litigation, since the enfranchisement premium would not depend on the calculations undertaken by one or other party, but instead would be generated by an external calculator.

7.10 As explained above, an online enfranchisement premium calculator would be most useful to leaseholders if it could tell them exactly what their enfranchisement premium will be. The more scope there is for uncertainty, the less useful the calculator will be. In order to generate definitive figures, it is necessary to remove, or reduce, the variable inputs into the calculation.

REDUCING THE VARIABLES BY PRESCRIBING RATES

7.11 Under each of the three valuation schemes in Chapter 5, enfranchisement premiums would be calculated based on a range of inputs. If all of the inputs to that calculation are known, then an online calculator could be devised that would tell the user what the enfranchisement premium is in their case. So introducing a workable and useful online

---

186 Assuming that the conventional valuation methodology is required to be used: see paragraph 5.124 and Option 4 above.
calculator depends on reforms being implemented that would reduce the number of variable inputs into the calculation.

7.12 If rates were prescribed (see Sub-option 1 in Chapter 6), then in the case of a standard individual enfranchisement claim (that is, a lease extension or an individual freehold acquisition where there is no additional value or other loss to be paid), all except one of the inputs would be fixed and ascertainable: see Figure 31.

**Figure 31: inputs for the calculation of the enfranchisement premium for an individual enfranchisement claim**

The inputs would be:

1. the length of the lease, the ground rent, and the ground rent review provisions, all of which would be clear from the lease;
2. the capitalisation rate, deferment rate, and relativity or no-Act deduction, all of which would be prescribed;
3. if different rates are prescribed:
   - for different categories of rent review provision;
   - for different geographical areas; and/or
   - for different categories of property;
   then the relevant category would need to be known, and that should be ascertainable by looking at the lease itself or from the leaseholder’s or landlord’s knowledge of the property; and
4. the FHVP value of the property, which would be variable.

7.13 The inputs would be the same for a collective enfranchisement claim, but such claims are more likely than individual enfranchisement claims to include additional sums (additional value and/or other loss) which would not be possible to calculate through an online calculator.

**THE REMAINING VARIABLE: FHVP VALUE**

7.14 In the case of a standard enfranchisement claim by an individual, the only remaining variable (if rates are prescribed) would be the FHVP value of the property. We

---

187 See Ch 2.
188 It may be necessary to provide various categories of different types of rent review provision, if different capitalisation rates are prescribed for different types of provision. There is a wide range of different types of rent review provision. We discuss some at para 2.17 onwards above, but any categories would need to allow for nuanced examples – for example, some reviews are to a percentage of the FHVP value at a future date, and some give two alternative options, such as the greater of RPI or 0.1% of the value of the property. If a cap on the treatment of ground rent is introduced (see Sub-option 2 in Ch 6), then the number of relevant categories would be reduced.
189 See n 189 above.
190 That is, a lease extension or an individual freehold acquisition claim where there is no additional value or other loss.
concluded above (at paragraph 6.116 onwards) that, whilst capitalisation and deferment rates, and relativity, could be prescribed, we did not think that FHVP values could be prescribed. If Government accepts that view, then the FHVP value will remain a variable input into the valuation calculation.

How is the FHVP value relevant to the calculation of enfranchisement premiums?

7.15 In the valuation of enfranchisement premiums under Schemes 1, 2 and 3, the FHVP is relevant to the calculation of “the reversion” (see paragraph 2.28 above), and to the calculation of marriage value (see paragraph 2.40 above), though the level to which it is relevant depends on the length of the lease.

FHVP value essentially irrelevant for long leases

7.16 For very long leases, the value of the reversion and marriage value is nil or negligible. Accordingly, the FHVP value makes no difference to the calculation of the enfranchisement premium.

House 3, for example, has 240 years unexpired. It has a reversionary value of just £3 (see Figure 5; para 2.39 above) and no marriage value is payable because the lease has over 80 years unexpired. Even a significant change to the FHVP value would make no difference to those aspects of the enfranchisement premium.

7.17 Even if the value of the reversion may be more than negligible, if a lease is long, any dispute about the FHVP is unlikely to make any, or much, difference to the calculation of the enfranchisement premium.

For example, say the FHVP value of a house is somewhere between £250,000 and £280,000.

- If it is held under a lease with 150 years unexpired, it would have a reversionary value of between £237 and £265.
- If it is held under a lease with 175 years unexpired, it would have a reversionary value of between £74 and £83.
- If it is held under a lease with 200 years unexpired, it would have a reversionary value of between £23 and £26.
- If it is held under a lease with 220 years unexpired, it would have a reversionary value of between £9 and £10.

In each of these cases, no marriage value is payable because the lease has over 80 years unexpired.

So even a significant change to the FHVP value would make little difference to those aspects of the enfranchisement premium.

7.18 Unless a property is particularly high value, then the value of the reversion will be nil or negligible if the lease has more than 240 years unexpired, and any disagreement about the FHVP value is unlikely to make much difference to the enfranchisement premium.
where the lease has more than 150 years unexpired. And if the lease has over 80 years unexpired, no marriage value will be payable.191

7.19 Accordingly, unless a property is particularly high value:

(1) for very long leases (over 240 years), an online calculator could provide the exact enfranchisement premium because all inputs would be (1) fixed, (2) ascertainable, or (3) (in the case of FHVP value) irrelevant to the calculation.

(2) for slightly shorter leases (over 150 years), an online calculator could provide an almost exact premium (within around £30) because any disagreement about the FHVP value will make little difference to the calculation.

FHVP value relevant for short leases

7.20 For short and mid-term leases (and long leases of particularly high value properties), however, there is value in the reversion, and marriage value may be payable.192 Accordingly, the FHVP does make a difference to the calculation of the enfranchisement premium.

House 1 has a reversionary value of £2,303, based on a FHVP value of £250,000 (see Figure 5; para 2.39 above). But:

- if the FHVP value were £200,000, then the reversionary value would be £1,843; and
- if the FHVP value were £300,000, then the reversionary value would be £2,764.

House 2 has a reversionary value of £7,349, based on a FHVP value of £250,000 (see Figure 5; para 2.39 above). But:

- if the FHVP value were £200,000, then the reversionary value would be £5,879; and
- if the FHVP value were £300,000, then the reversionary value would be £8,819.

7.21 Accordingly, for shorter leases, an online calculator could only provide the exact enfranchisement premium if the FHVP value to input into the calculator were known. And the FHVP value to input into the calculator – in order to generate the precise enfranchisement premium – would only be known if it had been agreed between the leaseholder and landlord, or determined by the Tribunal.

7.22 Nevertheless, if rates are prescribed, an online calculator would still be of significant benefit to leaseholders (and landlords) even before the point that the FHVP value had been either agreed or determined. That is because the calculator could provide certainty as to the range within which the enfranchisement premium will fall. Leaseholders will often have a reasonable idea as to the FHVP value (or likely range of values) of their property, or they can speak to a local estate agent.193 As we explain in paragraph 6.21(2) above, an online calculator could be used to determine precisely what the

191 Para 2.43.
192 If the lease has 80 years or less remaining, or if the 80-year cut-off is removed: see Sub-option 6 in Chapter 6.
193 See para 6.19.
enfranchisement premium will be at different FHVP values. So, for example, the leaseholder of House 1 would know that the enfranchisement premium will be £3,963 if the FHVP value is £230,000, and that it will be £4,331 if the FHVP value is £270,000. The leaseholder would be in a much stronger negotiating position than under the current law, where the range of possible premiums in such a case could be much wider.

Conclusion

7.23 In the case of standard enfranchisement claims by individuals, if rates are prescribed then an online calculator would be capable of providing a definitive answer as to what the enfranchisement premium will be at different FHVP values.

(1) In the case of very long leases, the FHVP value (or any dispute about the FHVP value) will make no difference to the premium, and so a calculator could generate the precise enfranchisement premium.

(2) In the case of shorter leases, the FHVP will make a difference, so a calculator could generate the precise enfranchisement premium only once the FHVP is agreed or determined. Before that point, the calculator could generate the range within which the enfranchisement premium will lie, but not the precise figure.

THE STATUS OF AN ONLINE CALCULATOR

7.24 If, as part of Schemes 1, 2 or 3, rates are prescribed and the conventional valuation methodology is required to be used in all cases, then the legislation will determine what the enfranchisement premium is. Put another way, the authoritative basis of the calculation, and the prescribed rates to be inserted, would be set out in the legislation. Any online calculator would generate an enfranchisement premium based on what the underpinning legislation required. So whilst the legislation, rather than the calculator itself, would determine the enfranchisement premium, the calculator ought to generate the correct figure by reflecting what the underlying legislation required.

7.25 An online enfranchisement premium calculator would be very similar to online tax calculators.

(1) The requirement to pay income tax, and the basis for the calculation of income tax, is set out in numerous Acts of Parliament. But taxpayers will rarely look at the legislation to determine how much income tax they have to pay. Rather, an online calculator – which reflects the underlying legislation – will tell the taxpayer what their tax liability is. In the same way, an online enfranchisement premium calculator – which would reflect the underlying legislation – would tell the leaseholder what their enfranchisement premium is.

(2) Before an online tax calculator can be used to generate the exact income tax liability, it is necessary to know the taxpayer’s taxable income. That is a variable


195 An online tax calculator is provided by HMRC, but there are also other tax calculators supplied by private organisations. We discuss below whether an online calculator for enfranchisement premiums should be provided by Government or left to private providers in the market.
figure. In the same way, before an online enfranchisement premium calculator can be used to generate the exact enfranchisement premium, it is necessary to know the FHVP value.

(3) If a taxpayer does not yet know their taxable income, an online tax calculator can still be useful to work out what their tax liability is likely to be (by inputting their estimated taxable income), or to work out the range of their likely tax liability (by doing two calculations, based on their minimum and maximum taxable income levels). In the same way, an online calculator would be useful for leaseholders to work out what their enfranchisement premium is likely to be (by inputting their estimated FHVP value), or to work out the range of their likely enfranchisement premium (by doing two calculations, based on a minimum and a maximum FHVP value).

CONSULTATION RESPONSES

Consultees in favour of an online calculator

7.26 In the Consultation Paper, we asked for consultees’ general views on the desirability and practicality of an online calculator. There was overwhelming support from consultees for an online calculator for enfranchisement premiums. These consultees thought that the benefits would be valuable.

“This is desirable. It will encourage leaseholders to investigate enfranchisement if they can quickly and easily get a quote. The big question in every leaseholder’s head is ‘How much is it going to cost?’” (National Leasehold Campaign, a leaseholder representative body)

“We consider that for enfranchisement valuations an online calculator is desirable and it should be available for as many types of claim as possible.” (LEASE)

“We strongly support the introduction of an online calculator and consider it to be a desirable feature of any new framework. The introduction of an effective online calculator will mean that the majority of leaseholders would have access to a substantially clearer, simpler and more cost-efficient regime, and therefore offers a better deal for leaseholders as consumers.” (Rothesay Life, a commercial investor)

“Absolutely. This would be conducive to a valuation system that is simple, reasonable, fair and clear - which would thereby be satisfactory to leaseholders and landlords alike, and remove the potential for dispute.” (Dan Smith, consultee)

“Yes, this would make life so much easier. At least we would know where we stand and how much it would cost. It would give us a baseline to work from.” (Russell Hughes, a leaseholder)

“Definitely desirable as leaseholders will be able to identify the cost at the outset and find out whether they can actually afford it.” (Carol Barber, a leaseholder)

“74.42% of [our] survey respondents agreed or strongly agreed that standardising rates could allow for the use of an online valuation calculator and indicated that this would be desirable for a range of reasons” (CILEx, a legal professional representative body)

7.27 Rothesay Life provided us with an online calculator which they had designed as part of their consultation response. The calculator was sophisticated, but remained user-friendly. The inputs required from the user were: lease expiry date, FHVP value, and
the annual ground rent (and any uplifts or reviews, including doubling ground rents or index-linked review schedules). 196 Behind the scenes, it was possible to alter elements of the calculation, such as the rates to be applied, the relativity graph to be used, and the length of the lease extension. The user of the calculator would not be concerned with these detailed elements, however – focussing merely on the simple inputs. The calculator produced three premiums: one for a freehold acquisition, one for a lease extension with a reduction of ground rent to a peppercorn, and one for a lease extension but retaining the existing ground rent and any reviews until the end of the original lease (this being an option we asked about in the Consultation Paper). 197

Consultees opposed to an online calculator

7.28 The arguments by consultees who had concerns about an online calculator fell into three broad categories. First, those consultees who were in favour of a simplified valuation regime – such as a multiplier of ground rent (see paragraph 5.10 onwards) above – thought that an online calculator would be redundant.

“A simple calculation based on 10 times ground rent would not require an online calculator.” (Hayes Point Collective Freehold Limited, consultee)

“I prefer the ordinary calculator that everyone has at home or on their phone [which] would do the job if extension was 9 x the original ground rent.” (Jeanette Allen, a leaseholder)

Given that we are not putting forward a simple multiplier as an option for reform, that particular basis for objection to the provision of an online calculator falls away.

7.29 Second, many consultees had concerns about an online calculator that were based on the use of online calculators presently in the market.

(1) It was said that some calculators are of dubious quality.

“In our experience there are dangers to the use of online calculations as they can lead to false expectation and results similar to automated valuations provided by property search engines. They have a place in helping to frame a range of outcomes but ultimately the nuances of valuation are best left to advising professionals.” (The Dulwich Estate, The Charity of Richard Cloudesley, and Dame Alice Owen’s Foundation, charitable sector)

“Some online calculators already exist and they are not fit for purpose.” (Midland Valuations Limited, surveyors)

If an online calculator is developed along the lines that we suggest above, then those concerns fall away. It would be possible to develop a good quality calculator, and as we discuss below, that could be done by Government rather than leaving it to the market.

196 There were also options to facilitate other proposals made by Rothesay Life for reforming valuation (see para 4.15).

197 Enfranchisement CP, para 4.46.
Some said that calculators would use rates that were not appropriate for the particular property or for particular leases. Similar arguments were made about different properties justifying different deferment rates or capitalisation rates.

“An online calculator cannot make allowances for tenant’s improvements, it cannot make allowances for deferment or capitalisation rates, unless these are prescribed, and it cannot determine relativity or ’93 Act Right allowances.” (Scrivener Tibbatts Ltd, surveyors)

But for the reasons set out above, we think that an online calculator would be of most use if rates are prescribed, and we have addressed arguments about the prescription of rates in Chapter 6.

There were concerns that an online calculator would provide the wrong answer if the wrong inputs were entered.

“On line calculators rely on the person inputting the variables for their accuracy.” (Nesbitt and Co, surveyors)

“… if the wrong or incorrect inputs are made into an online calculator (such as an incorrect capital value) the calculation will be wrong.” (Julian Wilkins & Co, surveyors)

“A mistake by a leaseholder could cost him dear. Do you imagine the freeholder saying he is paying too much?” (Anthony Brunt, a surveyor)

But prescribing rates would limit the number of variables that need to be inputted, and all other matters (save for FHVP value) should be easily ascertainable, for example from the lease itself: see Figure 31 above. Even the FHVP value is relatively easy to ascertain – at least within a range: see paragraph 6.19 above. Moreover, as explained in paragraph 7.24 above, it would be the underlying legislation – rather than the calculator itself – which was determinative. Accordingly, if the wrong figures are entered into the calculator, then the figure generated will not be correct (because it will not reflect what the underlying legislation requires) and will not stand as the enfranchisement premium in that case.

We acknowledge Anthony Brunt’s concern; there would be no mechanism to double-check for the leaseholder that he or she was not offering to pay too much by suggesting an unnecessarily high FHVP value. That is an inevitable consequence of reducing, or removing, the need for leaseholders to obtain professional advice from a valuer in order to make an enfranchisement claim. But leaseholders will continue to be able to take advice if they want it, or they could obtain a FHVP valuation from a local estate agent. We do not think that the risk of leaseholders, in rare cases, offering to pay too much (by using an unnecessarily high FHVP value) outweighs the benefits of an online calculator and the possibility of leaseholders thereby avoiding the need to pay for professional advice from a valuer in most enfranchisement claims.

There were concerns that online calculators are largely used as a marketing tool, and may be programmed to produce unrealistically low premiums so as to win business. Similarly, John Byers (a surveyor) said that:
“… it will be inequitable for one particular calculator to be given what would be some form of artificial statutory endorsement.”

Furthermore, it was suggested that online calculators can give leaseholders unrealistic views as to the premium payable, which leads to a greater risk of a dispute with the landlord.

“Online calculators should be treated with extreme caution as they can give the general public an unrealistically low or high indication of what the potential premium payable in their case might be.” (Carter Jonas LLP, surveyors)

Those might be reasons for Government to provide its own calculator, rather than leaving it to the market. But in any event, any reputable provider of an online calculator ought to be able to programme it with the relevant prescribed rates to produce results that exactly mirror the requirements of the underlying legislation.

7.30 The third category of concerns related to circumstances in which the use of an online calculator would be inappropriate, and which these consultees therefore said made an online calculator limited in use.

(1) It was said that an online calculator would not be appropriate where there are tailored or unusual rent review provisions.

“Having seen many online calculators in most instances there can be provisions within a lease that are not taken into consideration [such as] ground rent reviews.” (Andrew Richard Perrin, a surveyor)

But if capitalisation rates are prescribed – including, perhaps, different rates for different categories of rent review provision – then an online calculator would be appropriate. The calculator devised by Rothesay Life demonstrated that it is possible to include complex rent review structures in an online calculator.

(2) It was said that the calculator would not generate the correct answer if the regime includes a discount for tenants’ improvements or for holding over.

“Even the simplest calculation currently possible, ie over 80 years with a nominal fixed ground rent, can go wrong if the incorrect capital value is inserted and tenants improvements are not taken into account.” (Carter Jonas LLP, surveyors)

But if those elements of the scheme are retained, we have suggested that leaseholders should be able to elect whether they wish to rely on them: see Sub-options 6 and 7 in Chapter 6. Those discounts would affect the FHVP value that was inserted into an online calculator. We have already concluded that that figure would remain variable, and would need to be agreed between the parties or determined by the Tribunal. If a leaseholder wishes to argue that the figure should be further reduced to reflect the discount, he or she would be free to do so. And the online calculator would be able to help him or her to work out whether the cost, delay and uncertainty of arguing for a discount was worthwhile: he or she could see what effect a discount would have on the ultimate enfranchisement premium.
(3) Some consultees referred to cases where the property has development, or other additional, value, or where other compensation is payable for the effect the enfranchisement claim will have on the value of the landlord’s interest in other property (that is, for other loss). They said, and we agree, that those elements of value cannot be prescribed because they will always depend on the particular facts of the case.

“An online calculator cannot calculate a freehold claim when there are losses to a freeholder beyond term and reversion, eg development value, caretaker’s flat, carparking, vaults etc.” (Fanshawe White, surveyors)

But these additional elements of value feature less in an individual enfranchisement claim, as opposed to a collective enfranchisement claim. And in claims where development value exists (which would principally be collective enfranchisement claims, but perhaps also some individual freehold acquisition claims), we have suggested an option for reform that would prevent the leaseholders from being required to pay development value: see Sub-option 3 in Chapter 6. In those cases where a landlord can claim additional sums, an online calculator would not be capable of telling a leaseholder what additional sum will have to be paid. But it could include a note to the user explaining that an additional sum may, in certain circumstances, be sought by the landlord.

(4) Some consultees said that an online calculator would have limitations where there are one or more intermediate interests.

“An online calculator cannot determine an intermediate leaseholder’s ground rent capitalisation rate as it would not know the head leaseholder’s position (negative or positive). Consequently, an online calculator could not possibly determine an intermediate leaseholder’s split.” (Fanshawe White, surveyors)

We think that in a great many cases an online calculator ought to be able to take into account the existence of an intermediate lease in calculating the premium. We acknowledge that there may be limitations. However, as we explain at paragraph 1.60 above, we will consider issues relating specifically to the valuation of intermediate leases in our second report. Any proposals to reform the valuation of such leases will necessarily impact on the ability of an online calculator to take them into account. Consequently, in our second report we will also consider both the extent of, and the ability to overcome, any limitations of an online calculator where there is one or more intermediate interests.

(5) A few consultees commented that a calculator would not generate the correct answer (i) in the case of short leases, since they are valued by a different methodology, and (ii) where the lease terms are onerous, since that impacts on the value of the existing lease (thereby increasing the enfranchisement premium).

(a) We acknowledge that enfranchisement premiums currently reflect those particular features of the lease. However, the valuation reform that we envisage in order to support an online calculator would involve rates being

---

198 See para 2.61(2).
prescribed and the conventional valuation methodology (for long leases) being mandated in all cases. For the reasons explored in Chapter 6, that would involve different outcomes in some cases as compared with the outcomes that can be expected under the current law.

(b) If Government wants an online calculator to work for short leases (rather than excluding them from the scope of an online calculator) either a different valuation methodology could be mandated for short leases, or the conventional methodology that is mandated for most (longer) leases could also be applied to short leases. Such a possibility was suggested by Gerald Eve:

“Our suggested solution is therefore to prescribe deferment rates at the current Sportelli rates … We suggest that such a prescription apply to leases at all unexpired terms, including leases below 20 years. As such this would dispense with the complex approach for determining the deferment rate applicable for leases below 5 years unexpired as outlined in the Upper Tribunal decision of the Trustees of the Sloane Stanley Estate v Carey-Morgan,[199] commonly known as the Vale Court Approach. It would also remove the difficulties of determining the deferment rate applicable for reversions where the unexpired term is between 5 years and 10 years, for which there is no guidance from Upper Tribunal decisions, and for unexpired terms between 10 and 20 years, where the Upper Tribunal guidance, such as it is, is complex (Earl Cadogan v Cadogan Square Properties Limited).”[200]

(c) Similarly, if Government wants an online calculator to work even where a lease contains onerous terms (which would currently reduce the existing lease value, thereby decreasing relativity, and increasing the premium), the prescribed relativity could still be adopted. That would have the effect of disregarding the onerous terms. Many leaseholders would argue that onerous terms should, in any event, be disregarded when calculating an enfranchisement premium on the basis that landlords should not profit, at the leaseholder’s expense, from the existence of such terms.

Conclusion

7.31 None of the arguments raised by consultees who opposed an online calculator led us to conclude that it would be unworkable in practice. On the contrary, we agree with the overwhelming majority of consultees who thought that an online calculator would be useful and could work in practice. We think that an online calculator could be workable and helpful to leaseholders and freeholders alike.

HOW SHOULD AN ONLINE CALCULATOR BE ESTABLISHED?

7.32 We referred to various existing online calculators in the Consultation Paper. If rates are prescribed, it is likely that private organisations in the market would create online calculators for enfranchisement premiums. Some consultees expressed potential concerns about online calculators being provided by private organisations.

---

With clever online marketing companies some consideration needs to be given as to whether there is a clearly identified official calculator as firms wanting to win business will use an online calculator for lead generation. It may be necessary to prescribe the valuation basis that all suppliers must use so that all online calculators give the same answer, or as a minimum it's clear to consumers why two calculators give different answers.” (National Leasehold Campaign, a leaseholder representative body)

“When subscriptions are provided by the sector that the body is supposed to police this has been problematic as they have got too cosy with the people they are meant to oversee. The Government Communities and Housing Department should be responsible for setting up and maintaining the online valuation calculator - as the DWP agreed with regards to pensions.” (Andrea McKie, a leaseholder)

7.33 Government could provide its own calculator, in order to avoid the risk of different private providers producing slightly different calculators which might not be accurate. In addition, if a definitive calculator is provided by Government, steps can be taken to ensure it stays up to date, for example if and when the prescribed rates are changed. There would also be some quality assurance, so leaseholders and landlords could have confidence that the calculator they were using was providing an accurate enfranchisement premium. We therefore see considerable force in creating a single and authoritative Government-run online calculator.

CONCLUSION

7.34 The utility of an online calculator would depend on:

(1) rates being prescribed (see Sub-option 1 in Chapter 6), otherwise any calculator would be subject to much the same limitations as the online calculators in the market at present; and

(2) the legislation requiring that the conventional valuation methodology be used in all cases (see paragraphs 4.8 to 4.10, 5.93 and 5.124 above), otherwise the online calculator would potentially provide inaccurate results if an alternative valuation methodology could be adopted in a given case.

7.35 If rates are prescribed and the conventional valuation methodology is mandated in all cases – as we have said, in any event, is a necessary correlation to prescribing rates - then an online calculator would be useful and workable, and would deliver benefits addressing many of the problems with the current law identified in Chapter 3. Under whichever valuation scheme from Chapter 5 is adopted (whether it is Scheme 1, 2 or 3), an online calculator could provide an exact figure for an enfranchisement premium in a standard individual enfranchisement claim where the FHVP value has been agreed or determined. Where the FHVP value has not been agreed or determined, the online calculator could still provide the range within which the enfranchisement premium will lie. Depending on the valuation regime adopted, a calculator is likely to have certain limitations as described in paragraphs 7.30(3) and (4) above, and those limitations could be made clear to the user.
Benefits of an online calculator

Simplicity and accessibility
Certainty and predictability
Reduced professional costs
Reduced scope for inequality of power, and litigation tactics, to influence the outcome
Reduced disputes, costs and delays

Who would benefit?

Leaseholders (regardless of the length of their lease) and landlords.

Option 14.

7.36 If rates are prescribed (see Option 7 above,201 which we call “Sub-option 1”) and the conventional valuation methodology is mandated in all cases (Option 4 above),202 an online calculator could be introduced in order to tell leaseholders and landlords what the enfranchisement premium in a given case will be.

7.37 Once the freehold (FHVP) value of the property has been agreed between the parties or determined by the Tribunal, the online calculator could generate the precise enfranchisement premium. In rarer cases where additional value or other loss is payable, an online calculator could not generate the additional sum payable but could refer leaseholders to the possibility of this further sum being payable.

201 Para 6.115.
202 Para 5.124.
Chapter 8: Combining the new valuation “schemes” with the different “sub-options” for reform

INTRODUCTION

8.1 In Chapter 5, we set out three options for a new overall valuation scheme that could be adopted in order to reduce premiums for leaseholders. In Chapter 6, we set out various sub-options for reform that could be incorporated in those overall valuation schemes. The diagram on page 22 summarises those options for reform.

8.2 In this Chapter, we set out a table summarising the schemes and sub-options, who would benefit from them, and their compatibility with A1P1. We then set out a second table summarising how the schemes and sub-options could be used in combination.

SUMMARY OF THE SCHEMES AND SUB-OPTIONS

8.3 In the table below, we summarise the schemes and the sub-options that we put forward in this Report, which leaseholders would benefit from them, and their compatibility with A1P1.

<table>
<thead>
<tr>
<th>Option</th>
<th>Description</th>
<th>Who benefits?</th>
<th>Risk of successful challenge under A1P1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Leaseholders with 80 years or less unexpired</td>
<td>Leaseholders with more than 80 years unexpired</td>
</tr>
<tr>
<td>Scheme 1</td>
<td>Market value, assuming the leaseholder is never in the market: no marriage value is payable</td>
<td>✓ Premiums reduced</td>
<td>✗ No effect, on its own</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Yes, if combined with other reforms</td>
<td>✓ Yes, if combined with other reforms</td>
</tr>
<tr>
<td>Scheme 2</td>
<td>Market value, assuming the leaseholder is not now in the market, but may be in the future: hope value, but not marriage value, is payable</td>
<td>✓ Premiums reduced (though not as much as Scheme 1)</td>
<td>✗ No effect, on its own</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Yes, if combined with other reforms</td>
<td>✓ Yes, if combined with other reforms</td>
</tr>
<tr>
<td>Scheme 3</td>
<td>Market value, assuming the leaseholder is in the market: existing valuation methodology</td>
<td>✗ No effect, on its own</td>
<td>✓ Yes, if combined with other reforms</td>
</tr>
<tr>
<td>Option</td>
<td>Description</td>
<td>Who benefits?</td>
<td>Risk of successful challenge under A1P1</td>
</tr>
<tr>
<td>---------------</td>
<td>--------------------------------------------------</td>
<td>---------------</td>
<td>----------------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Leaseholders with 80 years or less unexpired</td>
<td>Leaseholders with more than 80 years unexpired</td>
</tr>
<tr>
<td>Sub-option 1</td>
<td>Prescribing rates at market value</td>
<td>✗ Premiums not reduced</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Other benefits, e.g. certainty</td>
<td>Medium Low to Low</td>
</tr>
<tr>
<td></td>
<td>Prescribing rates at below-market value</td>
<td>✓ Premiums reduced</td>
<td>Depends on social policy objective and level of premiums</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Other benefits, e.g. certainty</td>
<td></td>
</tr>
<tr>
<td>Sub-option 2</td>
<td>Capping the treatment of ground rent</td>
<td>✓ Benefits all leaseholders with onerous ground rents</td>
<td>Medium Low</td>
</tr>
<tr>
<td>Sub-option 3</td>
<td>Allowing leaseholders to elect to restrict</td>
<td>✓ Benefits leaseholders who would have to pay development value</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-option 4</td>
<td>Differential pricing for different</td>
<td>✓ Benefits owner-occupiers</td>
<td>Depends on social policy objective</td>
</tr>
<tr>
<td></td>
<td>leaseholders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-option 5</td>
<td>Removing the 80-year cut-off for marriage value</td>
<td>✗ No effect</td>
<td>✗ On its own, increases premiums</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>✓ Possibly, if combined with other reforms</td>
</tr>
<tr>
<td>Sub-option 6</td>
<td>Removing the discount for leaseholders’</td>
<td>✗ On its own, increases premiums</td>
<td>Not applicable</td>
</tr>
<tr>
<td></td>
<td>improvements</td>
<td>✓ Possibly, if combined with other reforms</td>
<td></td>
</tr>
<tr>
<td>Sub-option 7</td>
<td>Removing the discount for the risk of holding</td>
<td>✗ On its own, increases premiums</td>
<td>Not applicable</td>
</tr>
<tr>
<td></td>
<td>over</td>
<td>✓ Possibly, if combined with other reforms</td>
<td></td>
</tr>
</tbody>
</table>

203 Where the purchase price for the lease was not reduced to reflect the ground rent obligation.
ADOPTING ONE SCHEME WITH A COMBINATION OF SUB-OPTIONS

8.4 There are numerous possible combinations of one of the three schemes (from Chapter 5) with one or more of the seven sub-options (from Chapter 6).

8.5 In order to reduce premiums for leaseholders, and to simplify the enfranchisement process, Government and Parliament must weigh up the arguments and decide:

(1) whether to adopt Scheme 1, Scheme 2, or Scheme 3 (from Chapter 5). Only one of those schemes can be adopted.

(2) which combination of Sub-options 1 to 7 (from Chapter 6) to adopt. Any one or more of those sub-options could be adopted.

8.6 Those two decisions cannot be made in isolation from each other. The decision as to which scheme to adopt necessarily influences the decision as to which sub-option(s) to adopt. And a decision to adopt one sub-option necessarily influences the decision as to whether another sub-option should be adopted.

8.7 We do not comment on every conceivable combination of sub-options, within each of Schemes 1 to 3. Rather, in the table on the following page, we summarise whether and how the sub-options could be combined with each of the three different schemes.

8.8 Sub-option 1 (prescribed rates) would have to be adopted in order for a useful online calculator to be introduced.
<table>
<thead>
<tr>
<th>Sub-options: any can be selected</th>
<th>Schemes: one to be selected</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Scheme 1: Market value, assuming the leaseholder is never in the market</td>
</tr>
<tr>
<td></td>
<td>Sub-options that would reduce premiums</td>
</tr>
<tr>
<td>Sub-option 1: prescribing rates</td>
<td>✓ Only capitalisation and deferment rates need to be prescribed</td>
</tr>
<tr>
<td>Sub-option 2: capping the treatment of ground rent</td>
<td>✓</td>
</tr>
<tr>
<td>Sub-option 3: allowing leaseholders to elect to restrict development</td>
<td>✓</td>
</tr>
<tr>
<td>Sub-option 4: differential pricing for different leaseholders</td>
<td>✓ Possible, if required to justify lower premiums</td>
</tr>
<tr>
<td>Sub-options to be considered alongside other measures that would reduce premiums overall</td>
<td>✓ Unnecessary, since the scheme does not include marriage value</td>
</tr>
<tr>
<td>Sub-option 5: removing the 80-year cut-off for marriage value</td>
<td>✓</td>
</tr>
<tr>
<td>Sub-option 6: removing the discount for leaseholders’ improvements</td>
<td>✓</td>
</tr>
<tr>
<td>Sub-option 7: removing the discount for the risk of holding over</td>
<td>✓</td>
</tr>
</tbody>
</table>
INTRODUCTION

9.1 In this Chapter we consider premiums being calculated under the “original valuation basis” in section 9(1) of the 1967 Act and explore options for how that basis of valuation could be reformed.

9.2 As we explain in paragraph 1.30 above, the approach to calculating the premium payable when acquiring the freehold of a house or block of flats, or a lease extension of a flat, is broadly the same in all cases (which we refer to as the mainstream valuation basis) with one exception: section 9(1) of the 1967 Act (the original valuation basis).

9.3 The original valuation basis does not apply to any flats, nor does it apply to any lease extensions. It applies only in certain instances when a leaseholder is purchasing the freehold of a house under the 1967 Act. For section 9(1) to apply, the value of the house must fall below certain financial limits.

9.4 A premium calculated under section 9(1) using the original valuation basis is more favourable to the leaseholder than a premium calculated under the mainstream valuation basis. This is because the valuation under the original valuation basis is largely determined by an assessment of the market value of the land on which the house is situated, but not the value of the house itself. The landlord is therefore being compensated primarily for the loss of the land and not the loss of the building built on the land.

9.5 We set out below the current law in relation to section 9(1) and the problems with it. We then set out consultees’ responses and put forward two options for Government:

(1) Retaining section 9(1): given that, as we explain below, no truly equivalent but simplified and updated provision can be found to replace section 9(1), we consider whether it should be retained largely in its current form.

(2) Introducing an entirely new scheme providing a favourable valuation basis for low value properties: as an alternative to retaining section 9(1), we consider the idea of introducing an entirely new scheme designed accurately to identify low value properties and provide them with a more favourable basis of valuation than higher value properties.

THE CURRENT LAW

Current qualification criteria: when does the original valuation basis apply?

9.6 The original valuation basis under section 9(1) of the 1967 Act originally applied only to relatively low value houses. This was consistent with the original purpose of the 1967 Act which was to grant enfranchisement rights to leaseholders of low value houses only. As we explain further below, however, today, whilst section 9(1) still primarily applies to lower value houses, it does not apply to all houses which might be classed as lower value, and it also applies to some houses which would be classed as high value.
9.7 In order to qualify for a valuation under section 9(1) a house must:

(1) in most cases satisfy the original “low rent test” (set out in paragraph 7.30(1) of the Consultation Paper), except if the lease is granted on or after 7 September 2009 in which case the low rent test generally no longer applies;\(^{204}\)

(2) in all cases satisfy certain financial limits (set out in paragraph 7.50 of the Consultation Paper). There are two tests in this respect, set out at section 1(1)(a) of the 1967 Act. Which test is used depends on whether the lease was granted before or after domestic rateable values were abolished (on 1 April 1990). Where the lease was granted before 1 April 1990, the test is whether the rateable value of the property on the “appropriate day” was below a certain limit. Where the lease was granted on or after 1 April 1990 the test relies on a formula set out in section 1(1)(a)(ii) of the 1967 Act, where the outcome (“\(R\)” cannot exceed £25,000 on the date that the lease was entered into or contracted for (the test is commonly known as the “Find \(R\)” test). The purpose of the formula is to show whether, if the premium payable upon the grant of a lease were instead paid as an annual rent, that rent would be less than £25,000 per annum.

Current valuation methodology: what is the original valuation basis?

9.8 We explain the current valuation methodology under section 9(1) and the rationale for it in paragraphs 14.81 to 14.89 of the Consultation Paper. In short, a section 9(1) valuation produces a much lower premium than would be produced using the mainstream valuation basis because the premium is largely based on an assessment of the market value of the land on which the house is situated, but not the value of the house itself. The landlord is therefore primarily being compensated for the loss of the land and not the loss of the building built on the land.

9.9 The valuation methodology in section 9(1) reflects the idea underpinning the 1967 Act that, while the land belonged to the landlord, morally the house belonged to the leaseholder. As the authors of \(Hague\) suggest, this idea was no doubt intended to reflect the position at the grant of a normal 99-year building lease under which the landlord reserved a “ground rent” and the builder erected a building, making his profit by selling the lease with the building erected.\(^{205}\) Some consultees have also suggested that the 1967 Act was originally intended to apply to houses which were not expected to be standing at the expiry of the lease, which might also explain why it is primarily the value of the land on which the house is situated (and not the house itself) which is taken into account when determining the premium under section 9(1). With these concepts in mind, section 9(1) requires the calculation of the “site value” of the property.

9.10 As with the mainstream valuation basis, the starting point under section 9(1) is to ascertain the market value. However, section 9(1) requires the following two assumptions to be made:\(^{206}\)

\(^{204}\) Pursuant to s 300 Housing and Regeneration Act 2008.

\(^{205}\) \(Hague\) on Leasehold Enfranchisement (6th ed), para 1-08.

\(^{206}\) As well as a third assumption, that the sale is subject to any rentcharge to which the freehold is subject.
9.11 These two assumptions are what make section 9(1) the most favourable basis of valuation for leaseholders. The first assumption means that both marriage value and hope value are excluded from the calculation of the premium regardless of the length of the lease. The second assumption is what gives rise to the fact that a section 9(1) valuation is largely of the land on which the building is situated, but not the building itself. This is because the second assumption involves the calculation of a modern ground rent, which the 1967 Act requires be calculated by reference to the value of the land and not the value of the building on the land.\textsuperscript{208}

9.12 What is being valued under section 9(1) is therefore:

(1) the right to receive rent up to the end of the original lease;

(2) the right to receive a modern ground rent for 50 years after that under a hypothetical lease extension; and

(3) the right to have the property back at the end of that hypothetical 50-year lease extension.

9.13 The valuation methodology applicable to (1) and (3) is as set out in Chapter 2 above so:

(1) in valuing the right to receive rent up to the end of the original lease ((1) above), a “capitalisation rate” is applied to the ground rent payable over that term; and

(2) in valuing the right to have the property back ((3) above) at the end of the hypothetical lease extension, a “deferment rate” is applied to the freehold value of the property.

9.14 Whilst valuing the right to receive a modern ground rent ((2) above) requires capitalising the rent, it also involves:

(1) calculating the modern ground rent; and

(2) discounting the capitalised rent to reflect the fact that the second (hypothetical) lease would not start until the end of the original lease (that is, applying a deferment rate).

\textsuperscript{207} We explain how a modern ground rent is calculated in para 9.15 below.

\textsuperscript{208} The modern ground rent is calculated under s 15(2) 1967 Act, which requires at s 15(2)(a) that ‘the rent shall be a ground rent in the sense that it shall represent the letting value of the site (without including anything for the value of the buildings on the site)…’
Calculating the modern ground rent

9.15 A modern ground rent is a “ground” rent in the sense that it is intended to represent the letting value of the site, without including anything for the value of buildings on the site, with a review at 25 years. However, sites are not generally let in the open market for 50-year terms with one rent review at 25 years. Consequently, in the absence of comparables, valuers calculate the capital value of the site and then ascertain the return an investor would seek in respect of a site of that value taking into account the statutory assumptions (a process called “decapitalisation”).

9.16 There are three established methods for valuing the site, as set out in the Consultation Paper at paragraph 14.89: “the cleared site approach”, “the standing house approach” and “the new for old approach”. Of these, the most common is “the standing house approach”, because this approach applies where a house is likely to remain standing for the foreseeable future. Using this method, the site value is reached by ascertaining the FHVP value of the house, its “entirety value”, and applying a percentage to this value representing the proportion which relates to the site. This percentage varies by location.

9.17 Having established the site value, the second stage involves decapitalising the site value at an appropriate rate. In other words, whereas capitalising a ground rent involves taking an income stream and finding an equivalent capital value, decapitalising involves taking a capital value and finding an equivalent income stream.

Applying section 9(1) in practice

9.18 The responses to the Consultation Paper suggest that outside of London many leasehold houses qualify for a section 9(1) valuation, particularly in areas such as the Midlands and South Wales.

9.19 By contrast, in London, particularly Prime Central London, houses which qualify for a section 9(1) valuation are relatively rare. We think that those houses in Prime Central London which do qualify under section 9(1) tend to be mews houses, which originally comprised stables or garages with staff accommodation above, and were therefore not as valuable as surrounding properties, but which have now been converted to homes, so as to become relatively high value properties. These properties qualify under section 9(1) because the relevant lease predates 1 April 1990, is at a low rent (for example, it may be a peppercorn rent), and the house falls within the financial limits for section 9(1) because the rateable value by which this is determined is historic, and does not necessarily bear any relationship to the value of the property at the date of the enfranchisement claim.

9.20 Not all lower value houses qualify for a valuation under section 9(1). For example, as we note in paragraph 3.15 above, we have been told of a building outside London comprising a shop with accommodation above with a FHVP value of £275,000, and a 3-bedroom semi-detached house in Sutton Coldfield with a FHVP value of £285,000, both of which fell outside the financial limits for section 9(1).

---

209 1967 Act, s 15(2).
9.21 Section 9(1) is not limited to existing housing stock. Newly granted leases of either newly built or existing houses could qualify for a valuation under section 9(1) provided that they fell below the financial limits set out above. In practice, it is unlikely that newly granted leases of houses in Prime Central London would fall within these financial limits, but this may well not be the case outside London.

"In my opinion there is quite a big difference between the perception of the 1967 Act amongst surveyors and solicitors in London and surveyors and solicitors in the rest of England and Wales. In the preceding 5 financial years to the date of this response, I have undertaken 446 freehold purchases (acting for landlord and tenant) under the 1967 Act. Of these, only 3 have not been under s.9(1). Of the 3 cases, 1 was a detached house in a wealthy university city and 2 others were shops with accommodation over that would not be recognised by the ‘man in the street’ as being a house at all. The latter 2 were interesting as the counter-part valuer in each case, who was an experienced practitioner, was unaware that there was any other valuation basis for houses other than s.9(1). I believe that I would have had a similar response in any area in England and Wales, except Prime Central London." (Geraint Evans, a surveyor)

9.22 We have been provided with the particulars of various houses which qualified for a section 9(1) valuation together with the premiums paid for the freehold of those houses and the components of the valuations. For confidentiality reasons we have not replicated any of those valuations in this Report, but we have used them to put together two general examples, set out in Figure 32 below, of valuations carried out under section 9(1), together with an estimate of what would have been paid had the premium been calculated under section 9(1C) of the 1967 Act (that is, under the mainstream valuation basis). These examples show how much more beneficial to the leaseholder section 9(1) can be than section 9(1C).

### Figure 32: two examples

**House A** – based on a terraced house in London  
- Freehold value: £2,500,000  
- Unexpired lease term: 50 years  
- Ground rent: £250 per annum  
- Site value percentage adopted: 50%  
- Deferment rate on first reversion: 5%  
- Deferment rate on second reversion: 4.75%  
- Capitalisation rate: 6%  
- Premium under 9(1): £125,150  
- Premium under 9(1C): £449,800

**House B** – based on a terraced house near Swansea, Wales  
- Freehold value: £150,000  
- Unexpired lease term: 50 years  
- Ground rent: £15 per annum  
- Site value percentage adopted: 35%  
- Deferment rate on first reversion: 5%  
- Deferment rate on second reversion: 4.75%  
- Capitalisation rate: 6%  
- Premium under 9(1): £5,700  
- Premium under 9(1C): £27,000
PROBLEMS WITH THE CURRENT LAW

9.23 On the one hand, a valuation under section 9(1) is attractive to leaseholders because it produces a premium which is always significantly lower than a premium calculated under the mainstream valuation basis.

9.24 On the other hand, section 9(1) gives rise to problems for leaseholders, as well as for landlords. In Chapter 3: above we set out a number of overarching problems with the current law governing the calculation of premiums, many of which apply to leaseholders looking to exercise enfranchisement rights in reliance on section 9(1).

9.25 In addition to those overarching problems, the main two problems with section 9(1) are:

1. ascertaining which houses qualify for a valuation under section 9(1); and
2. calculating the premium payable under section 9(1).

Ascertaining which houses qualify for valuation under section 9(1): problems with the current qualification criteria

9.26 It is especially difficult to work out whether a house qualifies under section 9(1), as opposed to other sections of the 1967 Act which apply the mainstream valuation basis. Whether section 9(1) applies often depends on the historic rateable values of properties which sometimes cannot be traced – or can only be traced at great expense. This can be particularly difficult for leaseholders, leading to them incurring professional costs to determine which valuation basis applies to them, and creating the risk of selecting the incorrect method (with the potentially costly consequences that might follow from doing so). Sometimes, if it is not possible (even with professional assistance) to trace the historic rateable value for their property, leaseholders may have no choice but to pay a premium calculated under the mainstream valuation basis, when they should (had it been possible to trace the rateable value) have paid a much lower premium under the original valuation basis.

9.27 Moreover, the way in which the historic financial limits which govern whether section 9(1) applies operate in the present day can be irrational: as we note above there are houses which were of low value historically but are now very valuable, yet they enjoy the section 9(1) valuation basis; by contrast, there are houses which are currently worth far less, but which do not quite fall below the relevant financial thresholds, so the leaseholder must pay a premium based on the mainstream valuation basis. In other words, the qualification criteria for section 9(1) no longer accurately capture all lower value houses (some lower value houses appear to be excluded from section 9(1)) and nor do they accurately capture only lower value houses (some higher value houses currently qualify for a valuation under section 9(1)).

9.28 Leaseholders of houses are sometimes able to bring the valuation of the freehold within section 9(1) by obtaining a notional reduction in rateable value to take into account any leaseholder’s improvements in accordance with Schedule 8 to the Housing Act 1974. However, there are a number of criticisms of this Schedule.

1. The leaseholder’s improvements that are within the Schedule include improvements made in pursuance of an obligation to the landlord (and may even include the house itself if constructed pursuant to a building lease).
The Schedule includes unduly strict time limits that are a trap for the unwary.

The Schedule fails to provide for a notional reduction in respect of leaseholder’s improvements made after 1 April 1973, bearing in mind particularly that the relevant date for determining whether or not a house comes within the rateable value limit for a valuation under section 9(1) is now 31 March 1990.

The Schedule provides for a certificate from the valuation officer to specify the notional reduction only on 1 April 1973 whereas the relevant date under section 9(1A), which applies the mainstream valuation basis, is now 31 March 1990.

The procedural provisions of the Schedule are unsatisfactory in failing:

1. to require the landlord to serve a counter-notice to the leaseholder’s notice claiming a notional reduction;
2. to require the leaseholder to deliver to the landlord a copy of his or her application to the valuation officer; or
3. to deal with sub-tenancies.

There is no provision for an appeal from the valuation officer’s decision.

Calculating the premium under section 9(1): problems with the current valuation methodology

9.29 The valuation methodology under section 9(1) is not readily understandable. This can be particularly difficult for leaseholders, leading them to incur professional costs and increasing the risk of leaseholders paying a premium which is too high. The valuation methodology can be broken down as follows:

1. The rent payable under the existing tenancy needs to be capitalised. This is explained at paragraph 2.12 above.
2. The modern ground rent needs to be calculated. The valuation under section 9(1) is based on an assumption that the lease has been extended, when, as we explain at paragraph 9.31 below, it is in fact unlikely to have been. This, in itself, adds a layer of complexity not found in the mainstream valuation basis. However, to complicate matters further, that extended lease is assumed to be at a modern ground rent with a rent review at 25 years. As explained, calculating a modern ground rent requires finding a site value and as set out in the Consultation Paper there are various methods of doing this.
3. The modern ground rent needs to be capitalised. As the existing lease will not be at a modern ground rent (by definition it will usually be at a “low rent” in order to have qualified for a valuation under section 9(1) in the first place) and is unlikely to have one rent review at 25 years, the extended lease needs to be valued differently from the existing lease: a different capitalisation rate will usually be appropriate and account needs to be taken of the rent review. Indeed, the extended lease is likely to be valued differently from most other leases in the market, as a lease at a modern ground rent with one rent review at 25 years is rare. Further, there are two possible approaches to capitalising the modern...
ground rent: (a) it can be capitalised in perpetuity or (b) it can be capitalised to the end of the 50-year extended lease. Which approach is more appropriate will depend on the circumstances of the case.

(4) The value of the right to recover possession at the end of the 50-year extended lease needs to be ascertained, if the modern ground rent has only been capitalised to the end of that lease.

9.30 From the point of view of landlords, it can also be argued that the valuation methodology under section 9(1) is inequitable. In policy terms, the methodology is based on an assumption that the leaseholder owns the house already when exercising his or her right to enfranchise, but not the land on which the house is built. However, most leases are granted of houses that have already been built by the landlord (and which are intended to remain standing after the end of the lease), and so it is arguably unfair to the landlord not to receive compensation for the loss of the building as well as the land it is built upon when the leaseholder purchases the freehold.

9.31 In addition, as noted above, the original valuation basis is based on an unrealistic assumption that the leaseholder has exercised the right to a 50-year lease extension. This assumption has the effect of reducing the premium payable by the leaseholder, but is something which, in reality, few leaseholders would actually do.

THE CONSULTATION PAPER

9.32 In the Consultation Paper we asked for views as to whether section 9(1) should be retained in its current form (either indefinitely or for a limited period) or replaced with an equivalent but updated provision.

9.33 In terms of valuation methodology, we suggested that section 9(1) could be replaced with a new provision aimed at providing a right to buy the freehold of a house at a price equivalent to that calculated in accordance with section 9(1) but by simpler means.

9.34 We explained that analysis of a sample of section 9(1) claims suggested that a “term and reversion” valuation produced a premium roughly three times that produced under section 9(1). We suggested that the current section 9(1) valuation methodology could be replaced with a valuation based on term and reversion (for example, term and reversion divided by three) and that this would produce a simpler and more understandable valuation methodology.

9.35 As to the question of which houses should qualify for a valuation under section 9(1), we suggested that a replacement equivalent provision could provide for this to be determined:

(1) by reference to capital value;

(2) by reference to council tax banding;

(3) by reference to the location of the property;

210 See para 2.12 onwards and 2.28 onwards above.
by reference to an amended version of the current test for leases granted on or after 1 April 1990 (in other words, an amended version of the Find R test referred to in paragraph 9.7 above); or

by some other means.

**Consultees’ views**

**Should section 9(1) be abolished?**

9.36 Some consultees expressed the overarching view that section 9(1) should be abolished entirely.

9.37 If section 9(1) were abolished without any form of replacement, this would mean that the mainstream valuation basis would apply to all houses, including those which currently benefit from a valuation under section 9(1). Most consultees who expressed support for the abolition of section 9(1) clearly supported this outcome. With a few who appeared to support abolishing section 9(1), however, it was not always clear whether they actually favoured replacing section 9(1) with an equivalent provision rather than abolishing it without replacement. Further, it was not clear from some consultees’ responses whether they had understood that abolishing section 9(1) without replacement would result in a significant increase in premium for many leaseholders.

9.38 Support for abolition came mainly from professionals and landlords. Most of the consultees who supported abolition thought section 9(1) should be phased out by way of a sunset provision to give leaseholders a period of time in which to bring a claim under s.9(1) before it was abolished.

“Section 9(1) is an anomaly and should be abolished in my view. During a transitional period of say 10 years it should be possible to make a “legacy” 9(1) claim if all the old qualifying criteria (including that the property qualifies as a house under the old law) are met.” (Philip Rainey QC, barrister)

“The section 9(1) valuation basis is and has always been an anomaly. We consider that it should be repealed, and that a sunset provision (applicable for say 5/10 years) would be appropriate.” (Boodle Hatfield LLP, solicitors)

“These above all other aspects of leasehold legislation, are entirely artificial. So, for example, to qualify for section 9(1), you need to check the rateable value and many councils no longer keep those records. They then depend on valuing a site, which is more or less unknown in Central London, and then adopting a yield on a site, which is another unknown factor, and then applying something called the Haresign addition. Each stage relies on an artificial assumption unrelated to the real world. These section 9(1) claims should be abolished.” (Church Commissioners for England)

“...section 9(1) is inequitable to the landlord. Clearly it does not provide sufficient compensation to the landlord. The only excuse for its retention is that its abolition would lead to increased premiums for some house leaseholders. That is not a sufficient or equitable reason. It is nonsensical to continue with a valuation method that is acknowledged to be based on an incorrect fiction and an unrealistic assumption. Clearly the landlord is not receiving sufficient compensation – one third of the true value is clearly in contravention of A1P1. Therefore section 9(1) needs to be abandoned and one method for all houses and flats incorporated.” (Anthony Shamash, a commercial investor)
“No [section 9(1)] should not be maintained – simplification has to mean that you bring all leasehold properties into a single regime.” (Church & Co. Chartered Accountants)

9.39 As to the length of a sunset period, views ranged in the main from two years to ten years. Some consultees said that a sunset provision should be accompanied by a drive to get those who would benefit from a section 9(1) valuation to enfranchise before the sunset period expired.

9.40 The main arguments made in favour of abolishing section 9(1) can be summarised as being that section 9(1) is complex, artificial, an anomaly, and fails adequately to compensate landlords. Some consultees in favour of abolition also felt strongly that the enfranchisement regime as a whole needed to be simplified and thought that in order to achieve this there could only be one valuation regime for all flats and houses. Other consultees felt that section 9(1) should be abolished because it is no longer widely used (although our consultation responses suggest that this is not in fact the case).

9.41 A few consultees made comments that suggested support for a partial abolition of section 9(1) based on geographical area, retaining section 9(1) only for Wales and other areas where average house prices are lower than Prime Central London.

“Properties in Greater London should be excluded from any future section 9(1) valuations.” (Damian Greenish, solicitor)

“So far as concerns London and home counties properties I cannot see the justification for retaining the differential between 1967 and 1993 Act valuations. I do understand that in Wales and up north it is a very different set of circumstances.” (Bruce Maunder-Taylor, a surveyor)

“Section 9(1) should be retained in Wales and other low value areas.” (David Evans, consultee)

Should the section 9(1) valuation methodology be retained in its current form?

9.42 A number of consultees favoured the indefinite retention of the existing section 9(1) valuation methodology. Those in favour of this approach were mostly regional valuers who are very familiar with the valuation methodology under section 9(1) and, therefore, do not regard it as being in any way complicated or requiring simplification. Some consultees went as far as to say that any change to the valuation methodology was likely to increase the cost to the leaseholder. We are not sure exactly why this would be the case, other than that there might be an initial cost involved in advisers taking time to get to grips with a new methodology (although this should not be significant if the new methodology is sufficiently clear and simple).

“In practice [the valuation methodology in section 9(1)] is not regarded by the many practitioners in the field as being in any way complicated or requiring simplification.” (Geraint Evans, a surveyor)

“The section 9(1) valuation methodology should be retained for so long as there remain leasehold houses that qualify under this basis of valuation… In general and particularly from the valuer’s point of view the current methodology is not particularly complex and quite routine for the experienced valuer dealing with leasehold reform valuations.” (Leasehold Forum, a body representing enfranchisement professionals)

“I do not see the section 9(1) methodology as being particularly complex and has been applied for over 50 years.” (Nesbitt and Co, surveyors)
“The current methodology is not complex, and it is routine for the experienced valuer dealing with statutory claims.” (Scrivener Tibbatts Ltd, surveyors)

9.43 However not all valuers agreed.

“Section 9(1) valuations are recognised to be one of the more, if not the most, complex of all the statutory Leasehold Reform Act valuations provisions and, given that it applies for the lowest value houses, its continued retention places a continued cost and burden on both leaseholder claimants and landlords responding to enfranchisement claims made under this section. The costs and burden are two-fold; firstly in terms of legal costs incurred by claimants and landlords in identifying that the property in question satisfies the relevant financial criteria (rateable value) for section 9(1) to apply and secondly in terms of valuation costs in assessing correctly the relevant complex components of the section 9(1) valuation as applicable to the property in question.” (Gerald Eve LLP, surveyors)

9.44 LEASE and a few other consultees expressed support for the retention of the section 9(1) valuation methodology in its current form. In some cases, this may have been on the basis that consultees thought they were being asked to make a straight choice between retaining section 9(1) (and being able to benefit from the more favourable valuation basis) and abolishing section 9(1) (and having to pay a significantly higher premium under the mainstream valuation basis). It was not always clear from responses whether consultees were giving a view on the slightly different question as to whether the section 9(1) valuation methodology should be retained in its current form, or replaced by a simplified equivalent provision. It is also possible that some consultees were unaware of the limitations on the scope of section 9(1); for example, that it does not apply to flats, or the problems that arise from the valuation methodology used under section 9(1). It is understandable, in those circumstances, that consultees said they favoured retaining section 9(1).

“We consider the Section 9(1) valuation methodology should be retained for as long as possible and certainly whilst there are leasehold houses that qualify under this valuation basis by falling within the original definitions in the 1967 Act.” (LEASE)

9.45 Some consultees supported the retention of section 9(1) but (as with a few consultees who favoured abolishing section 9(1)) only because they thought section 9(1) rarely applied. In fact, as we note in paragraph 9.18 above other responses to the Consultation Paper suggest that this is not the case. A few landlords were in favour of retaining the current section 9(1) valuation methodology. However, they largely did not explain their reasons for preferring this option to replacing the valuation methodology with an equivalent.

9.46 Some consultees also qualified their response, including:

(1) by saying that the qualification criteria for applying section 9(1) should be simplified; or

(2) in some other way. For example, Sarah Foster of Rowland Jones Chartered Surveyors suggested the valuation methodology in section 9(1) could be retained for existing stock only but not new leasehold houses.
Should the current section 9(1) valuation methodology be replaced with an equivalent but simplified provision?

9.47 There was considerable support amongst all categories of consultees for simplifying section 9(1) by replacing the valuation methodology. Leaseholders were particularly supportive of simplifying the current law, although (understandably, given the technical nature of the question) large numbers of leaseholders answered this question by expressing overarching, general views which were not specifically focused on section 9(1). For example, leaseholders expressed the view that the valuation methodology across the enfranchisement regime as a whole should be replaced with a simpler, more readily understandable methodology, or that all enfranchisement premiums should be calculated as a multiple of ground rent.

“We believe that a simplified methodology is a necessity, particularly if the outcome is to provide a simpler and fairer enfranchisement regime for leaseholders. As a group of private home owners who want to purchase the freehold title to provide security of ownership, the current regime is impenetrable, as an illustration, even responding to much of the detail in this consultation is too complex for anybody without a legal background.” (Mark Tomkins, members of a leaseholders’ residents association).

“Valuation methodology should possibly be retained for a short period no longer than 3 months to ensure a smooth transition. Valuation methodology should be replaced by a much simplified methodology easily understood by leaseholders.” (An anonymous consultee)

“Just make the calculation as simple as possible and preferably one which can be accessed online via the internet to determine the value of the freehold purchase.” (Ian Humphreys)

9.48 Aside from leaseholders, a significant number of other consultees, including some professionals, the British Property Federation and some landlords, were of the view that the valuation methodology in section 9(1) should be replaced with a simplified alternative. The main reason given for replacing section 9(1) was that the current valuation methodology is too complex, which leads to increased professional costs being incurred in the enfranchisement process.

“We consider option (2) is the most sensible replacement of the existing, over complicated methodology” (British Property Federation)

“Section 9(1) valuations ought to be replaced with a simplified methodology. The existing scheme is cumbersome to operate ….” (Cerian Jones, a surveyor)

9.49 Even if they did not explicitly say that they thought section 9(1) should be replaced with a simplified valuation methodology, a proportion of those responding gave views on what any revised methodology should be. In other words, there was overlap between those that offered views on a revised methodology, but also showed support for the retention or abolition of section 9(1).

9.50 Some consultees suggested replacing the valuation methodology with that used in the 1993 Act. However, this would effectively be the same as abolishing section 9(1), since it would mean that premiums currently calculated under section 9(1) would instead be calculated using the mainstream valuation basis (and would consequently increase for leaseholders). Others felt that a “term and reversion” valuation under the mainstream valuation basis, but without marriage value, would suffice. That would be the same as
Scheme 1 in Chapter 5 above. Again, however, such an approach would not replicate the favourable valuation methodology in section 9(1) and would, in effect, be a form of abolition, significantly increasing premiums for leaseholders.

9.51 The majority of consultees who offered views as to an alternative methodology favoured using a percentage of term and reversion (as we suggested in the Consultation Paper) or term plus a percentage of reversion, the latter being a more sophisticated approach and one which more closely mirrors the premiums currently produced under section 9(1). A percentage of term and reversion was suggested in the Consultation Paper and those who showed support for this approach, for example the RICS, seemed to agree with us as to the general principle that a simplified methodology along these lines was desirable rather than necessarily preferring our suggested replacement methodology in the Consultation Paper to the more sophisticated term plus a percentage of reversion approach.

9.52 As to a term plus percentage of reversion, Tapestart Limited suggested that the percentage of reversion should be 50% where the FHVP value is £100,000 or less reducing by 1% for every £1,000 above £100,000. This, of course, pre-supposes that the revised methodology would only apply to properties which have a FHVP value of £150,000 or less (meaning that the mainstream valuation basis would apply to houses valued over £150,000, which would significantly increase premiums for many leaseholders).

9.53 Otherwise, the consultees suggesting a term plus percentage of reversion approach agreed that the percentage of reversion should be equivalent to the “site value proportion” prevailing for the location in question. Gerald Eve LLP modelled the effect of such a revised methodology using the example of a house worth £325,000. Their modelling appears at Appendix 4: and is summarised below in Figure 34.

9.54 Gerald Eve identified a difficulty in that they did not think it was possible to find a simplified methodology which could exactly replicate section 9(1) premiums. With this in mind Gerald Eve expressed support for the idea of phasing out the current section 9(1) methodology gradually via a sunset provision, in order to give those leaseholders who would have to pay a higher premium under the new methodology the chance to purchase the freehold at the current lower premium. Other consultees also identified that there may be difficulty in identifying a replacement valuation methodology which exactly replicated the premiums under section 9(1), and were concerned that this might cause problems in respect of A1P1.
of landlords will be undermined if a move from (1) to (2) results in a materially lower premium.”

(Maddox Capital Partners Limited, landlord)

Should the current qualification criteria under section 9(1) be replaced with an equivalent simplified provision?

9.55 There was very considerable support for replacing the current qualification criteria under section 9(1) amongst all categories of consultee, even those who thought the existing valuation methodology under section 9(1) should be retained. Many consultees thought that the current reliance on rateable values is outdated and causes difficulties in practice.

9.56 The majority of consultees who responded to this part of the question favoured the use of council tax banding to determine which properties should qualify under section 9(1). The reasons for preferring council tax banding were that this information is readily available, unarguable and most closely resembles rateable values, on which the applicability of section 9(1) was originally determined.

9.57 There were, however, a number of critics of the use of council tax banding. Carter Jonas LLP did not feel council tax banding would work given regional variations and many leaseholders felt council tax banding was arbitrary.

"Council tax banding, whilst currently used, is archaic: it is based on historical 1991 values and circumstances. Problems will no doubt arise as to the appropriate band possibly involving the VOA in an already depleted and overworked Department. In any case as with the 1973 Valuation Lists, Council Tax may well cease and be replaced." (Each Side Leasehold, surveyors)

"I definitely feel that valuation based upon council taxes would be unfair since virtually identical properties of similar value next to each other in our block have recently been found to be in different Council Tax bands!" (Jonathan West)

9.58 The second most popular option was a revision of the “Find R” test. This option was supported by a number of professionals and landlords. Robert Wood suggested an adaptation of the Find R test. However, Damian Greenish said that, whilst Find R may be the fairest means of determining the applicability of section 9(1), it is not simple to apply.

9.59 A number of consultees favoured using capital value to determine applicability. However, the main difficulty identified with using capital value was regional variations in the order of house prices. Perhaps for this reason, Cottons surveyors suggested using capital value and location.

9.60 Other suggestions put forward as to replacement qualification criteria were as follows:

(1) capital value and lease length (Church & Co Chartered Accountants);

(2) an original GIA limit of, say, 1,000 square feet (Carter Jonas LLP), on the basis that section 9(1) was intended for small houses;
9.63 We first discuss three possibilities for reform which we do not put forward as options for Government:

(1) extending the valuation methodology in section 9(1) across the entire enfranchisement regime;

(2) abolishing section 9(1) without any form of replacement; and

(3) replacing section 9(1) with an equivalent but simplified and updated provision.

9.64 We then discuss two possibilities which we do put forward as options for Government:

(1) retaining section 9(1) largely in its current form; and

(2) replacing section 9(1) with an entirely new scheme designed accurately to identify low value properties and provide them with a more favourable valuation basis.
OPTIONS NOT PUT FORWARD FOR GOVERNMENT

(1) Extending section 9(1): should the original valuation basis under section 9(1) be extended across all enfranchisement claims?

9.65 Since it provides the most favourable basis of valuation for leaseholders, and we are asked to explore options for reducing premiums paid by leaseholders across the entire enfranchisement regime, it is logical to ask whether the valuation methodology contained in the original valuation basis could be adopted as the single method of valuation for all enfranchisement claims.

9.66 As we note above, however, the rationale which underpinned the introduction of the original valuation basis in section 9(1) is not applicable today. Section 9(1) is in many ways an historical anomaly which was designed to produce a premium for the low value properties to which the 1967 Act originally applied, but which does not reflect the realities of modern leasehold ownership. It would therefore be unsatisfactory, as a matter of policy, to extend the section 9(1) valuation basis to all enfranchisement claims.

9.67 Additionally, as we set out above, section 9(1) is arguably unfair on landlords as it compensates them primarily for the loss of the land, and not the building built on the land. Whilst our Terms of Reference require us to consider options to reduce the premium payable by leaseholders to enfranchise, we must also ensure sufficient compensation is paid to landlords to reflect their legitimate property interests. Extending section 9(1) beyond its current ambit would not further this objective.

9.68 Further, as explained above, the valuation methodology used by the original valuation basis is complex and not readily understandable, particularly by leaseholders. We do not consider therefore that adopting the original valuation basis for other enfranchisement claims would further the policy objectives set out in our Terms of Reference of simplifying enfranchisement legislation, or of making enfranchisement easier, quicker or more cost effective.

9.69 For these reasons, we do not suggest that the original valuation basis should be adopted as the single method of valuation for all enfranchisement claims.

(2) Abolishing section 9(1): should section 9(1) be abolished entirely without any form of replacement?

9.70 The original valuation basis under section 9(1) is an exception to the mainstream valuation basis which applies to all other enfranchisement claims. Our Terms of Reference require us to consider how enfranchisement legislation could be simplified and made easier, quicker and more cost effective (by reducing the legal and other associated costs) particularly for leaseholders. These objectives would be furthered if section 9(1) was abolished entirely without any form of replacement, so that exactly the same valuation methodology as is applied to properties which currently qualify for the mainstream valuation basis, could also be applied to houses which currently qualify for the original valuation basis under section 9(1). We also acknowledge that a number of consultees supported the abolition of section 9(1).

9.71 On the other hand, however, our consultation has shown us that section 9(1) is still widely used by leaseholders, particularly outside Prime Central London. If section 9(1) were abolished without any form of replacement, premiums would be significantly
increased for a great many leaseholders who currently benefit from the more favourable valuation basis under section 9(1). This would particularly affect those who own lower value leasehold houses outside London, especially in areas like the Midlands and South Wales. Abolishing section 9(1) would remove something of real value to these leaseholders whilst giving landlords a windfall, a result which would not have been anticipated by either leaseholders or landlords when they purchased their interests in these houses. Abolishing section 9(1) may even put enfranchisement out of reach entirely for some leaseholders who cannot afford the increase in premium.

9.72 The effect on leaseholders of abolishing section 9(1) could be mitigated by having a sunset provision. This would allow leaseholders a limited period of time following the introduction of a new enfranchisement regime, during which leaseholders who currently qualify for a valuation under section 9(1) could still benefit from such a valuation before the original valuation basis is abolished.

9.73 Even if a sunset provision were accompanied by a publicity campaign to raise awareness amongst leaseholders, however, this would not ensure that all leaseholders could take advantage of a valuation under section 9(1) before the provision was abolished. Many leaseholders will not have enfranchised already because they simply cannot afford to do so. Even with a lengthy sunset clause (of, say, 10 years), this may not be long enough for everyone to raise funds to enfranchise: some leaseholders will sell without ever enfranchising, whilst others will be forced to sell to someone who can afford to enfranchise because the length of the lease is such that they risk losing their asset altogether if they do not. In addition, one of the difficulties with section 9(1) is that leaseholders will not necessarily know that it applies to them without specialist advice. We are concerned that a drive to encourage leaseholders who qualify under section 9(1) to take advantage of a sunset period might well result in leasehold professionals (and non-professionals) cold calling leasehold house owners, with no ready means of establishing whether in fact they would qualify under the section.

9.74 We therefore consider that there are compelling policy reasons why section 9(1) should not simply be abolished without any form of replacement, even with a sunset provision, solely in order to simplify and streamline the enfranchisement regime. In any event, we consider that because it would lead to a significant increase in premiums for leaseholders, it would be contrary to our Terms of Reference to put forward as an option for Government the abolition of section 9(1) without any form of replacement, either with immediate effect or following a sunset period.

Abolishing section 9(1): partial abolition based on location

9.75 We acknowledge that there were some consultees who thought it might be appropriate to have a partial abolition of section 9(1), by expressly limiting its application to certain parts of the country outside London. It is true that just because a house is low in value relative to other houses in the area does not necessarily make it a “low value” house relative to houses in other parts of the country. We note, however, that section 9(1) currently applies nationally (as do all other aspects of the enfranchisement legislation).

---

211 That is the case not only under the existing mainstream valuation basis, but under each of the schemes we have put forward for reform. Premiums would increase under each of Schemes 1, 2 and 3 (in Chapter 6) since those schemes all involve premiums including a sum to reflect the value of “the term and reversion”, whereas section 9(1) produces lower premiums than that (see para 9.8).
and it would be a significant shift from this position in policy terms if its application were expressly limited only to certain regions. It would also arguably complicate the enfranchisement regime if section 9(1) only applied to certain parts of the country and not others. Further, it would also have the effect of increasing premiums for leaseholders who fell outside those regions to which a revised section 9(1) applied. For these reasons, we do not suggest any partial abolition of section 9(1) based on geographical areas.

(3) Replacing section 9(1) with equivalent provision

9.76 Given some of the complexities of the current law identified above, one potential option for reforming section 9(1) would be to replace it with an equivalent but updated and simplified provision. We suggested this option in the Consultation Paper and asked for consultees' views on various ways of updating both the current qualification criteria and the valuation methodology.

9.77 The aim of such reform would be to find a new provision which replicates the results produced by the current section 9(1) (both in terms of those leaseholders who qualify for a section 9(1) valuation and the amount of the premium), whilst being simpler and more readily understandable. As some consultees identified, it is particularly unfair that a valuation basis which applies, generally, to lower value houses, should be so complex to understand and implement.

9.78 The main argument raised by consultees for retaining section 9(1) in its current form (as opposed to replacing it with an equivalent, updated provision) was that it is not complicated to practitioners familiar with the section. This argument pre-supposes, however, that leaseholders should have to continue to use (and pay for) specialist professional advisers to the same extent as is required at the moment when enfranchising. If there is some equivalent, but simpler, alternative to section 9(1) that could replace section 9(1), this is something that would be of great benefit to leaseholders and landlords alike.

9.79 As to the more general argument that it would be unfair not to retain section 9(1), this argument would largely fall away if section 9(1) were replaced with an equivalent provision, which replicated the results produced by section 9(1), both in terms of the categories of leaseholder who qualify for a valuation under section 9(1) and the level of premium they are required to pay.

Replacing section 9(1) with equivalent provision: no truly equivalent provision

9.80 Whilst it might be desirable to replace section 9(1) with an equivalent but simplified provision, we have found that in practice this gives rise to difficulty.

9.81 The problem we have encountered is that none of the options for reforming section 9(1) appear to produce results which are truly equivalent to section 9(1). In other words, it does not appear to be possible to identify a simplified, updated provision which replicates the results produced under section 9(1), either in relation to qualification criteria or in relation to valuation methodology.
Replacement Qualification Criteria

9.82 In the Consultation Paper, we suggested a number of possibilities for replacing the qualification criteria for section 9(1) with a simplified equivalent. The three alternatives most supported by consultees were, in order of preference, criteria based on:

(1) council tax banding;
(2) the Find R test; and
(3) capital value.

9.83 We have been provided with the particulars of a number of houses which currently qualify for a section 9(1) valuation, including the FHVP value of those houses. We have used these examples to consider the extent to which the different alternative replacement qualification criteria set out above would replicate the results produced by the existing qualification criteria.

9.84 In carrying out this exercise, we have not found it possible to identify a simplified, updated test which would mirror the results produced by the current qualification criteria; in other words, it does not appear that any of the alternatives set out above would ensure that all and only those houses that currently qualify for a favourable valuation under section 9(1) would continue to do so under the replacement provision.

9.85 In respect of each possible alternative replacement qualification criterion we think that some houses (we cannot say how many) which currently qualify for a valuation under section 9(1) would no longer qualify under the replacement provision, meaning that those affected leaseholders would have to pay a higher premium under the mainstream valuation basis.

9.86 We also think, on the flip side, that some houses (we cannot say how many) which currently qualify for the mainstream valuation basis would qualify for a lower premium under the replacement section 9(1) provision. Whilst this would result in a reduction in premiums for some leaseholders, it would mean that their landlords would be worse off, as they would be receiving significantly less compensation than they would have received under the mainstream valuation basis.

(1) Council Tax

9.87 Whilst use of council tax banding was the most popular option amongst consultees as a replacement qualification test for section 9(1), council tax banding does not appear to be a reliable touchstone for identifying those houses to which section 9(1) currently applies.

9.88 Council tax bands are based on the price a property would have sold for on the open market on 1 April 1991 in England and 1 April 2003 in Wales. We have considered a sample of 44 houses which qualified for a section 9(1) valuation and looked at the council tax band those houses fell within: four fell within band A; 11 fell within band B; 10 fell within band C; six fell within band D; three fell within band E; three fell within band F; six fell within band G; and one fell within band H. In other words, there is no apparent correlation between council tax banding and the properties to which section 9(1) currently applies.
9.89 Further, there appears to be little correlation between Council Tax bands and current property values. Our research revealed that a property with an estimated freehold value of £2,145,044 fell within band A, being the lowest value band, whereas properties in Wales with freehold values of £190,000 and £240,000 fell within higher value bands (D and F respectively). Consequently, it does not appear that Council Tax bands could be used reliably to identify houses which could today be described as “low value”. The most that can be said is that Council Tax bands can be used to identify properties which were “low value” on 1 April 1991 in England and 1 April 2003 in Wales.

9.90 It seems likely to us, therefore, that if council tax banding is used as the replacement qualification criteria for section 9(1), then houses which currently qualify for a section 9(1) valuation will no longer do so, and houses which currently qualify under the mainstream valuation basis will suddenly qualify under section 9(1).

(2) The “Find R” test

9.91 The second most popular option amongst consultees to replace the current qualification test under section 9(1) was to extend a version of the Find R test across all section 9(1) claims (currently it applies only to leases granted on or after 1 April 1990). The Find R test is designed to identify low value properties, and should be much more successful at achieving this aim than, say, council tax banding.

9.92 We think that criticism that the Find R test is complex to apply could be easily overcome by the provision of an online calculator (or just the use of a scientific calculator). The formula for finding R is shown in Figure 33 below. It requires the input of the premium payable on the grant of the lease and the term of the lease, in other words, the number of years it is granted for. However, both of these pieces of information are readily ascertainable from the lease itself. Once these figures are known, finding R is a mathematical calculation. It does not require any assessment of the relevant rate, as this has already been prescribed. Consequently, that mathematical calculation could easily be performed by an online calculator.

**Figure 33: the “Find R” test**

\[
R = \frac{P \times I}{1 - (1 + I)^{-T}}
\]

where —

“P” is the premium payable as a condition of the grant of the lease (and includes a payment of money’s worth) or, where no premium is so payable, zero,

“I” is 0.06, and

“T” is the term, expressed in years, granted by the lease (disregarding any right to terminate the lease before the end of the term or to extend the lease).
9.93 R cannot exceed £25,000. The Secretary of State has power by statutory instrument to replace the sum of £25,000 and to change the number in the definition of “I”. The Ministry of Housing, Communities and Local Government previously consulted on whether the sum of £25,000 should be increased, but it has not been. However, if the applicability of the Find R test was widened to include pre-1 April 1990 leases and the rates to be used under the mainstream valuation basis were prescribed, then whether the sum of £25,000 or the number in the definition of “I” should be changed could be considered at the same time as those other rates are considered.

9.94 However, although the Find R test might be useful in identifying low value properties, we do not think that it could be used accurately to identify all and only those houses to which section 9(1) currently applies. Clearly, the Find R test in its current form could be used to identify some of the houses to which section 9(1) applies (since it forms part of the current qualification criteria for leases granted on or after 1 April 1990). The problem comes in using the Find R test to identify those leases which predate 1 April 1990, and which qualify for a valuation under section 9(1) by virtue of their rateable values.

9.95 It has been difficult to look in detail at how accurate the Find R test is at identifying houses which do or do not qualify for a section 9(1) valuation if applied to leases granted before 1 April 1990. This is because it requires knowing the premium payable on the grant of the lease, and we have not always had access to this information. However, as explained in the Consultation Paper and above, the Find R test is used to identify houses where, if the premium payable upon the grant of the lease of the house was instead paid as an annual rent, that rent would be less than £25,000 per annum. We think the test was introduced on the basis of a policy decision by Government at the time that houses with an annual rental value of less than £25,000 should qualify for a more favourable valuation under section 9(1). We do not think that the Find R test was intended or designed by Government to identify accurately all those houses, and only those houses, which would otherwise have qualified for a section 9(1) valuation due to their historic rateable values. It does not appear likely, therefore, that the Find R test would replicate the results produced by section 9(1) in terms of qualification criteria.

(3) Capital Value

9.96 The third most popular option amongst consultees for replacing the qualification criteria under section 9(1) was using capital value. The simplest way of implementing this method would be to set a single, absolute capital value threshold. Any house below the threshold would qualify for a valuation under section 9(1). An alternative would be to set the threshold as a percentage of the average UK house price at the date of the enfranchisement claim, by reference to the UK House Price Index. This would allow the threshold to work more flexibly and reflect the fact that house prices vary over time, and also by area.

9.97 In respect of each example section 9(1) valuation supplied to us, we have been made aware of the house’s capital value, and have also been able to ascertain what the

---

212 1967 Act, s 1(7).

average property price is for the area in which the house is situated, according to HM Land Registry. Average property prices are broken down by HM Land Registry by area or by the type of property: flat or maisonette, detached house, semi-detached house or terraced house, but not by both area and type. For example, it is possible to ascertain what the average price was for a terraced house in the UK in June 2019 or what the average price was for a property in Westminster in June 2019, but not what the average price was for a terraced house in Westminster in June 2019.

9.98 Having considered the data we do have, there is no apparent correlation between qualifying for a section 9(1) valuation and absolute capital value or capital value relative to average property prices in the area in which the house is located. We think it unlikely that even having access to the more sophisticated data identified above (for example, knowing what the average price was for a terraced house in Westminster in June 2019) would help to find a correlation between capital value and properties currently qualifying for a valuation under section 9(1). As we note in paragraph 9.19 above, one of the reasons that section 9(1) operates arbitrarily today is that it uses historic rateable values to determine whether a property qualifies for a section 9(1) valuation, and such historic rateable values do not always bear any resemblance to the property’s current capital value. Consequently, we have again concluded that it is unlikely to be possible easily to identify those houses which would currently qualify for a section 9(1) valuation by reference to capital value (either absolute capital value or capital value relative to average property prices in the area in which the house is located).

9.99 Accordingly, if a simple test based on capital value were introduced as a replacement for the current qualification criteria under section 9(1) then we think it likely that, unavoidably, some houses which currently qualify for a section 9(1) valuation would no longer qualify, and vice versa.

Replacement Valuation Methodology

9.100 In terms of an equivalent, simplified valuation methodology for section 9(1), consultees suggested a valuation based on term and a percentage of reversion. This suggestion is an extension of the approach we identified in paragraph 15.24 of the Consultation Paper (which proposed calculating the term and reversion value, and then dividing this figure by three). Our research and consultee responses suggest that, compared to the approach we identified in the Consultation Paper, the term and percentage of reversion method would produce premiums which are more similar in amount to those currently produced under section 9(1). That is because term and percentage of reversion more closely resembles the current valuation methodology than the alternative that we put forward in the Consultation Paper, and will take more account than the alternative of regional variations in value.

9.101 As explained in paragraph 9.16 above, the calculation of the premium under section 9(1) involves finding the “site value” of a property. Valuers generally calculate this as a percentage of the value of the property (that is, house and land) as a whole. If the term and percentage of reversion method were used, we would suggest that the percentage of the reversionary value which is to be paid to the landlord should be the same percentage as that currently used to determine site value. For example, in the above examples at Figure 32, the premium payable for the house in London was calculated applying a site value percentage of 50%, whereas the premium paid for the house near Swansea used a site value percentage of 35%.
9.102 The term plus percentage of reversion method is slightly more complicated than the one we proposed in the Consultation Paper, but this additional complication would be minimised if the relevant site value percentages were prescribed. Further, if deferment and capitalisation rates were prescribed, as discussed in Chapter 6, then the capitalisation and deferment rates to be used under this method could also be prescribed, which would simplify it further.

9.103 However, the premiums produced by the term and percentage of reversion method would not be exactly the same in all cases as those produced by the current section 9(1) methodology. In some cases, the premiums payable by leaseholders would be greater than under the current section 9(1) and in some cases the premiums payable would be less.

9.104 We note above that Gerald Eve LLP provided modelling as part of their consultation response calculating the effect on premiums of replacing section 9(1) with a term and percentage of reversion valuation methodology. The Gerald Eve model used one example of a house with a FHVP value of £325,000. We have carried out further, similar calculations in order to gauge what the impact of the term and percentage of reversion methodology might be on a higher value house in London (worth £2,500,000) and a lower value house outside London (worth £150,000) and the results appear at Appendix 4. The results of both Gerald Eve’s modelling and our modelling are summarised in Figure 34 below.

---

**Figure 34: Comparing premiums under s.9(1) with premiums calculated under term plus percentage of reversion valuation methodology**

**Overview:** The modelling calculates the difference between the premium currently produced under section 9(1) and the premium produced under the term plus percentage of reversion valuation methodology suggested by consultees. The difference in premium is assessed assuming that an enfranchisement claim is brought at various different points in a lease term (ranging from an unexpired term of 1 year to an unexpired term of 140 years). Three examples are used: houses worth £150,000, £325,000 and £2,500,000 respectively.

**EXAMPLE 1**

**FHVP value of house:** £150,000  
**Site Value Percentage:** 35% (example assumes house outside London only)

With unexpired lease terms of over 50 years, leaseholders would pay the same or virtually the same premium as under s.9(1). With unexpired lease terms of 50 years or less leaseholders would pay a lower premium than under s.9(1) (6% lower with an unexpired lease term of 50 years, increasing to 16% lower with an unexpired lease term of 1 year).

**EXAMPLE 2**

**FHVP value of house:** £325,000  
**Site Value Percentage:** 35% (assuming house outside London); 50% (assuming house in London)

In London – with unexpired lease terms of 50 years or more, leaseholders would pay slightly more than they do currently (up to 10% more). With unexpired lease terms of less than 50 years leaseholders would pay a lower premium than under s.9(1) (up to 8% lower).
Outside London – with unexpired lease terms of more than 80 years, leaseholders would pay the same or slightly more than they do currently (up to 4% more). With unexpired lease terms of 80 years or less leaseholders would usually pay a lower premium than under s.9(1) (up to 14% lower).

**EXAMPLE 3**

**FHVP value of house:** £2,500,000  
**Site Value Percentage:** 50% (example assumes house in London only)

With unexpired lease terms of 50 years or more, leaseholders would pay more than under section 9(1) (up to 19% more). With unexpired lease terms of under 50 years leaseholders would pay less than under s.9(1) (up to 8% less).

9.105 The modelling shows that whilst the revised methodology produces broadly similar results to the premiums currently produced under section 9(1) in many cases, the premiums are not identical. There are instances in these examples in which the leaseholder would have to pay more than currently (up to 19% more in the most extreme case), and instances in which the leaseholder would have to pay considerably less (up to 16% less in the most extreme case). In these examples, leaseholders would pay a lower premium than under section 9(1) in cases where they had a relatively short unexpired lease term, and a similar or higher premium compared to section 9(1) where they had a longer unexpired lease term.

**Replacing section 9(1) with equivalent provision: difficulties caused by lack of truly equivalent provision**

9.106 The lack of any truly equivalent, simplified provision to replace section 9(1) gives rise to difficulties. As we explain above, in terms of qualification criteria, it appears that whatever replacement option is selected, premiums will inevitably increase for some leaseholders because they will no longer qualify for a valuation under section 9(1) and will have to pay a significantly higher premium under the mainstream valuation basis. Likewise, it appears likely that premiums will decrease significantly for other leaseholders because they will qualify for a more favourable valuation under section 9(1) when they currently pay a premium calculated under the mainstream valuation basis.

9.107 In relation to valuation methodology, likewise, it appears that even if a term and percentage of reversion methodology were used, some premiums will inevitably increase and some will decrease compared to the current position under section 9(1).

9.108 The fact that premiums will inevitably increase for some leaseholders if section 9(1) is replaced does not sit within our Terms of Reference, which require us to examine options to reduce the premiums payable by leaseholders.

9.109 There is, however, a more fundamental problem caused by the fact that premiums would decrease for some leaseholders if section 9(1) were replaced by a simplified provision (and, correspondingly, their landlords would receive less than they currently do when leaseholders acquire their freeholds). The problem this reduction in premium gives rise to is that it is unlikely that any scheme to replace section 9(1) with an equivalent but simplified and updated provision would comply with A1P1. This issue is discussed further below.
Replacing section 9(1) with equivalent provision: compatibility with A1P1

9.110 In relation to the replacement of section 9(1) with an equivalent, but simplified, provision, Counsel has advised as follows:

The section 9(1) basis of valuation is somewhat of an historical anomaly. If it were to be introduced now, it may well be considered to violate A1P1. However, it has previously been held to be lawful, and its lawfulness was not subsequently challenged on the abolition of the residence requirement, and the expansion of the categories of leaseholder who may benefit from it to include corporate bodies and/or investors. Leaseholders and landlords have conducted their affairs for over 30 years on the basis that the section 9(1) basis of valuation is lawful. Given that retaining section 9(1) cannot be unlawful, it is therefore unlikely that replacing section 9(1) with an equivalent but simplified provision would be unlawful.

However, that assessment depends on any simplified replacement provision being equivalent to section 9(1) both in terms of who would qualify to benefit from the replacement basis of valuation and in terms of the amount of the premium payable. In my view, the guiding principle should be that landlords should be no worse off under a replacement provision than they already are under section 9(1). That is because section 9(1) represents the outer limits of compatibility with A1P1. The further that a replacement provision moves away from the current qualifying criteria and the premiums currently payable under section 9(1), the greater the likelihood that the replacement provision would be assessed by the Courts on its own merits (rather than simply being viewed as equivalent to section 9(1)) and held to be incompatible with A1P1.

9.111 Counsel’s advice is that ‘the guiding principle’ in terms of ensuring that any equivalent replacement provision is compatible with A1P1 is that ‘landlords should be no worse off under a replacement provision than they already are under section 9(1)’. As we note above, however, we have not found it possible to comply with this ‘guiding principle’.

9.112 The most significant problem arises in relation to replacement qualification criteria. Counsel’s view is that the lack of any equivalent provision to replace the qualification criteria for section 9(1) gives rise to two risks in terms of a challenge on A1P1 grounds. In fact, it does not appear to be possible to identify a simple test which would mirror the current qualification criteria. This gives rise to two risks. First, there is the litigation risk that there will be landlords of properties which do not currently qualify for a valuation under section 9(1) but which would be brought within the scope of any replacement provision, who will therefore be incentivised to challenge the compatibility of the replacement provision with A1P1. Second, there is the risk that the replacement qualification criteria will be found to be irrational or arbitrary on their own terms and/or which fail to achieve their designed purpose of replicating the section 9(1) qualification criteria.

For example, I understand that there is no apparent correlation between Council Tax banding and the properties to which section 9(1) currently applies. Further, there appears to be little correlation between Council Tax bands and current property values. Consequently, it does not appear that Council Tax bands could be used reliably to identify houses which could today be described as “low value”. Given that the original
rationale for section 9(1) was to grant enfranchisement rights to leaseholders of low value houses only, there is a risk that a purported replacement for section 9(1) based on Council Tax bands will capture houses which would not have been caught by section 9(1) and which could not be regarded as low value and will therefore beheld to be irrational or arbitrary and in breach of A1P1. I assess such a risk as Medium High.

9.113 Counsel advises that in the event that the qualification criteria for section 9(1) were replaced with a test based on council tax banding, then it is likely that this could be successfully challenged on A1P1 grounds (counsel gives the risk rating as Medium High).

9.114 We acknowledge that Counsel is of the view that the risk of a successful A1P1 challenge would ‘probably be lower’ if the replacement qualification test was based on Find R or capital value. However, Counsel does not express the view that the overall risk rating in these circumstances would be any lower than Medium High. Moreover, as we note above, tests based on Find R and capital value both suffer from the same underlying problem as council tax banding, in failing precisely to replicate the scope of the current qualification criteria under section 9(1). All three tests would be likely therefore to leave some landlords worse off than under the current section 9(1) (those landlords whose properties currently qualify for a valuation under the mainstream valuation basis, but which would qualify for a less favourable valuation under the new provision replacing section 9(1)). All three tests could also be criticised on the ground that they failed to achieve their designed purpose – that purpose being to replicate the results produced by section 9(1).

9.115 We asked Counsel whether it would assist if the existing qualification criteria were retained for a sunset period after a replacement provision was introduced. Counsel advises that this would not make a successful challenge on A1P1 grounds any less likely. A sunset provision in itself is not problematic from an A1P1 perspective. It is designed to provide some protection for existing leaseholders for a time-limited period, without at the same time preventing ultimate reform of current valuation provisions. However, it does not address the problem identified above, namely, that landlords will be brought within the scope of a replacement provision who do not currently qualify for a valuation under section 9(1). Further, it will not save replacement qualification criteria which are otherwise irrational or arbitrary from being held incompatible with A1P1.

9.116 We also asked Counsel whether it would assist if Government were to replace section 9(1) with an updated provision but limit the ambit of the replacement provision to existing leases. Again, Counsel did not consider that this would reduce the risk of a successful challenge on A1P1 grounds. I do not consider it would assist to limit the replacement section 9(1) provision to existing leases of existing properties. In fact, it would introduce a further disparity, which may be hard to justify, in that leaseholders of existing leases would pay less to purchase their freeholds than leaseholders of new leases of exactly the same value.
9.117 As to replacement valuation methodology, Counsel has advised as follows.

In my view, in the context of valuation methodology (as opposed to qualification criteria), compatibility with A1P1 is likely to depend on the number of landlords who receive considerably reduced premiums in the event the valuation methodology was replaced. If very few landlords would be affected by the reduced premiums, then the Court is more likely to take the view that landlords as a group are not being made to bear an excessive burden; if, however, large numbers of landlords would be affected, the Court is more likely to conclude that the replacement valuation methodology does not strike a fair balance between the rights of landlords and the general interests of society (including leaseholders).

9.118 Given the limitations of the modelling we have been able to undertake, we are not able to say exactly how many landlords would be affected if the valuation methodology under section 9(1) were replaced with the term plus percentage of reversion method we set out above. Further modelling would need to be carried out in order to collect this information. However, the basic modelling we have undertaken suggests that it is possible that significant numbers of landlords would receive reduced premiums if the term plus percentage of reversion method were introduced to replace section 9(1), particularly where enfranchisement occurs when tenants’ unexpired lease terms are relatively short.

9.119 We consider that the problem set out above in relation to A1P1 is insuperable, at least in relation to qualification criteria. We have not found it possible to identify simplified, equivalent qualification criteria, which would not leave landlords worse off than under section 9(1), or which would fulfil their designed purpose of replicating section 9(1).

9.120 We acknowledge that Counsel has not categorically advised at this stage that replacing the valuation methodology with a term plus percentage of reversion methodology would be incompatible with A1P1. However, we would not suggest to Government that it should consider replacing the valuation methodology under section 9(1) in circumstances where it could not also replace the current qualification criteria. Such a strategy could potentially amount to a complicated halfway-house, reforming section 9(1) in part only (whilst leaving the qualification criteria untouched). Moreover, there is no guarantee that a scheme which replaced the valuation methodology under section 9(1) would ultimately be compatible with A1P1. Such a scheme is still likely to give rise to the risk of a challenge on A1P1 grounds without solving all the problems with section 9(1). We do not therefore consider that the benefits of altering the valuation methodology alone would outweigh the risks and downsides involved in doing so.

9.121 For the reasons set out above we do not put forward replacing section 9(1) with an equivalent, updated provision as an option for Government.

OPTIONS PUT FORWARD FOR GOVERNMENT

(1) Retaining section 9(1)

9.122 One option which Government could adopt is simply to retain section 9(1) indefinitely and largely in its current form, including retaining the current qualification criteria and valuation methodology. In this scenario, whatever reforms Government might make to the mainstream valuation basis, section 9(1) would remain as an exception.
9.123 This would, all other things being equal, be an unattractive proposition since it would fail to address the problems with the current section 9(1) set out above. On the other hand, apart from abolishing section 9(1) completely without replacement, it is the only way wholly to avoid the difficulties which result from attempting to reform section 9(1).

9.124 In particular, retaining section 9(1) in its current form ensures that exactly the same leaseholders who currently qualify for the more favourable valuation under section 9(1) will still qualify when the enfranchisement regime is changed. There would be no need for a sunset provision of any type, since no leaseholders would lose the right to a more favourable valuation under section 9(1). It also ensures that leaseholders who qualify under section 9(1) will still pay the same premium as they do currently.

9.125 It should also avoid any issue in terms of A1P1. As we explain in paragraph 15.6 of the Consultation Paper, the courts have already found that section 9(1) in its current form is lawful and compatible with A1P1. By retaining section 9(1) no landlord will be in a worse position than they are currently, since there will be no change to the class of leaseholders who qualify under section 9(1), and nor will there be any reduction in the premiums those qualifying leaseholders pay.

**Retaining section 9(1): prescribing rates for the valuation methodology**

9.126 If the current valuation methodology under section 9(1) is retained, it might be possible to simplify the current methodology by prescribing rates. The valuation methodology in section 9(1) involves capitalisation and deferment rates, and we have discussed in Chapter 6 how these rates could be prescribed. We leave open the question as to whether it might also be possible to prescribe site value percentages in the context of section 9(1). If rates were prescribed, this might even enable the use of an online calculator to calculate the premium under section 9(1).

9.127 Prescription of rates and the provision of an online calculator would be of considerable benefit to both leaseholders and landlords. They would not, however, assist in all cases. For example, in the case of leases pre-dating 1 April 1990 parties would still have to incur the expense of tracing historic rateable values. In those cases where historic rateable values were required but could not be traced, neither prescribed rates nor an online calculator would be of any use in providing a valuation under section 9(1) (and the leaseholder would still have no choice but to forego the opportunity of a section 9(1) valuation entirely).

9.128 Prescribing rates in this context would potentially give rise to the risk of incompatibility with A1P1, if it led to a reduction in premiums payable to landlords. Counsel has advised as follows:

> ...in my view, the same principles apply to considering the compatibility of prescribing rates in the context of retaining section 9(1) in its current form as apply to prescribing rates under the general approach, save that the rates prescribed under section 9(1) should not result in the payment of premiums that are lower than currently produced under section 9(1) in line with the guiding principle that landlords should be no worse off than they already are under section 9(1).

---

214 *James v United Kingdom* (1986) 8 EHRR 123.
Prescribing rates (and using an online calculator) for section 9(1) would only, therefore, be possible provided that this would not result in lower premiums than those currently paid by leaseholders under section 9(1).

Retaining section 9(1): the impact of Government’s proposed ban on leasehold houses

Government has announced that it intends to ban the grant of new long leases of houses. Once the ban is introduced then, with some exceptions, it will only be possible to sell houses on a freehold basis (as opposed to a long leasehold basis). There will be no need for those buyers to purchase their freehold (whether under section 9(1) or under the mainstream valuation basis) because they will already own the freehold.

The ban will not mean that no new leases of houses will be granted in the future because first, there will be some exceptions to the ban; and secondly, the ban will not apply retrospectively to leasehold land which was already owned prior to the date the ban was first announced in December 2017. However, the ban will drastically reduce the number of newly granted leases of houses in the future.

Correspondingly, if section 9(1) is retained, its application will be significantly reduced going forward and limited to existing leases (together with any newly granted leases of houses which are not subject to the ban). Eventually, after a considerable period of time, it is likely that all existing leaseholders who currently qualify for a premium under section 9(1) will have exercised the right to purchase their freehold, or their lease will have expired. The application of section 9(1) will then be limited solely to those newly granted leases which are not subject to the ban.

(2) Replacing section 9(1) with an entirely new scheme providing a favourable valuation basis for low value properties

A more fundamental and far-reaching reform would be to replace section 9(1) with an entirely new scheme designed accurately to identify low value properties and provide them with a more favourable valuation basis.

Section 9(1) was originally designed to apply only to certain low value houses. As we note above, part of the problem with the current section 9(1) is that it no longer fulfils this purpose: there are houses which were low value historically but are now very valuable, yet they enjoy the section 9(1) valuation basis; by contrast, there are houses...

---


216 In other words (aside from various categories of exemptions, such as National Trust land, shared ownership properties and retirement properties) when it comes into force the ban on the granting of new long leases of houses will apply to:

(a) any land held only as freehold (ie with no leasehold also on the title), regardless of when the freehold title was acquired; and

(b) any leasehold land acquired from 22 December 2017 onwards (but not leasehold land acquired prior to that date).

which are currently worth far less, but which do not quite fall below the relevant financial thresholds, so the leaseholder must pay a premium calculated on the mainstream valuation basis.

9.135 In these circumstances, and particularly given the other problems we have identified with section 9(1), Government could consider introducing an entirely new scheme which is designed accurately to apply to all low value properties and exclude higher value properties, and which provides leaseholders of low value properties with a more favourable basis of valuation. A new scheme would ensure that leaseholders of (all and only) low value properties are given more assistance to enfranchise than leaseholders of higher value properties (similar in some ways to the way in which owners of lower value properties pay a lower percentage of Stamp Duty Land Tax than owners of higher value properties).

Replacing section 9(1) with entirely new scheme: what might a new scheme look like?

9.136 In this Report, we make only broad observations as to what form the new scheme might take. We are not putting forward for Government any specific suggestions as to how a new scheme might operate (and nor have we consulted on any particular scheme). We think the point of principle as to whether or not Government wishes to introduce an entirely new scheme favouring low value properties needs to be decided before further consideration is given to the detail of the scheme.

9.137 In addition, it would be sensible for Government to decide what reforms it wishes to make to the mainstream valuation basis, before deciding what form a new scheme favouring leaseholders of low value properties might take. It might be possible, and preferable, for Government to use the same overarching valuation basis to calculate the premium for all enfranchisement claims (whatever the value of the property being enfranchised), but to adapt the calculation where the claim relates to a low value property, rather than a higher value property. An example of such a scheme would be if premiums for all properties (high and low value) were calculated using the same basis of valuation but Government prescribed rates (such as capitalisation and deferment rates) at different levels, say below-market rates for low value properties and market rates for higher value properties.

9.138 The ability to have a single overarching scheme adapted for low value properties (as in the example set out above), is a potential advantage of introducing a new scheme (as opposed to retaining section 9(1)). It presents an opportunity to achieve a simpler, more coherent and more consistent enfranchisement regime as a whole. By contrast, if section 9(1) is retained, it will be an exception to the rest of the enfranchisement regime. Premiums under section 9(1) will be calculated using an entirely different valuation basis to premiums not falling under that section.

9.139 In terms of qualification criteria, the scheme might use one of the options we discussed above for replacing section 9(1) with an equivalent provision: for example, the scheme might provide that to qualify for the more favourable valuation a property would have to fall under a certain capital value or Find R threshold. Alternatively, the new scheme might use a different test for identifying those low value houses it is intended to benefit. The choice of test is largely a matter of policy for Government. It is for Government to identify which properties it considers to be low value and deserving of benefitting from the new scheme (this is not a matter on which we express a view).
9.140 We consider that, although they could in theory look similar, a new scheme of this type would be qualitatively different from the various schemes we set out above for replacing section 9(1) with an equivalent provision. The aim of an entirely new scheme would not be to try to simplify the complexities of section 9(1) by introducing an equivalent provision, but a broader aim of giving leaseholders of low value properties additional assistance to enable them to purchase their freeholds. As such, the new scheme need bear little or no resemblance to section 9(1).

Replacing section 9(1) with entirely new scheme: which properties would the new scheme apply to?

9.141 Whilst section 9(1) applies only to houses, a new scheme could apply to both flats and houses meeting the qualification criteria.

9.142 The ability to include low value flats as well as houses could be seen as an advantage of introducing an entirely new scheme. Leasehold ownership of flats is far more prevalent now than it was when section 9(1) was originally introduced. It might, therefore, be seen as fairer and more consistent with the realities of modern leasehold ownership to introduce a new scheme which applies to both low value flats and houses.

9.143 In the Consultation Paper we provisionally proposed removing the distinction between flats and houses, and introducing the term ‘residential unit’ to cover both types of property. If this provisional proposal were to be adopted, Government could provide that a new scheme applied to all ‘residential units’.

Replacing section 9(1) with entirely new scheme: what should happen to section 9(1)?

9.144 If a new scheme were introduced, a decision would need to be taken as to what should happen to section 9(1). There are two main options for how section 9(1) could be dealt with upon the introduction of a new scheme:

1. section 9(1) could be abolished with immediate effect; or

2. section 9(1) could be retained temporarily (for a sunset period) for existing leases which qualified for a valuation under section 9(1) at the point at which the new scheme was introduced.

9.145 Option 1 (immediate abolition) would be the simpler way forward. However, it would mean that premiums would immediately increase for some (and potentially all) leaseholders who currently benefit from section 9(1). There are two ways that premiums might increase if section 9(1) were abolished immediately on the introduction of the new scheme. First, leaseholders of higher value properties who currently qualify under section 9(1) would not qualify under the new scheme (so their premiums would inevitably increase). Second, depending on the terms of the new scheme, even leaseholders of low value houses who do qualify for a valuation under the new scheme might pay an increased premium compared to section 9(1), unless Government chose a valuation methodology for the new scheme which closely replicated the results produced by section 9(1).

9.146 Option 2 would be a more complex way forward. We envisage that the two schemes (the new scheme and section 9(1)) would need to run side by side for the length of the sunset period. Having two schemes in place will be confusing for leaseholders and will
increase their costs. Leasehold owners who do not qualify under the new scheme are still going to have to take advice as to whether they might qualify for a section 9(1) valuation. Moreover, even if a leaseholder clearly qualifies for a valuation under the new scheme, they might still need to take advice as to whether a lower premium would be payable under section 9(1). On the other hand, retaining section 9(1) for a sunset period would allow leaseholders who would have qualified for a section 9(1) valuation, but who do not qualify under the new scheme (or who would pay a lower premium under section 9(1) than the new scheme) the chance to take the benefit of section 9(1) whilst it remains in force.

9.147 We acknowledge that similar disadvantages might apply to a sunset period in this context as we discuss at paragraph 9.73 above (where we considered abolishing section 9(1) without replacement). However, the situations are not identical. If a new scheme were introduced, then at the end of the sunset period leaseholders of low value houses would still qualify for a valuation under the more favourable new scheme. By contrast, if section 9(1) were abolished without replacement, then at the end of the sunset period, leaseholders of low value houses would have to pay a much higher premium under the mainstream valuation basis alongside all other leaseholders.

9.148 We have considered a third option (as an alternative to either option 1 or option 2 in paragraph 9.144 above): that of retaining section 9(1) indefinitely for existing leases when the new scheme is introduced. We have discounted this option. It would be undesirable as it would involve all the complications of option 2 in terms of running section 9(1) and the new scheme side by side, but would prolong those complications for an indefinite period. More fundamentally, however, Counsel has advised that it is likely that this option would be incompatible with A1P1 (see paragraph 9.151 below).

9.149 We put both options 1 and 2 forward at this stage for Government to consider. Which option is more suitable will depend on what form any new scheme (and the reformed enfranchisement regime as a whole) takes, and how it affects leaseholders' premiums.

Replacing section 9(1) with entirely new scheme: compatibility with A1P1

9.150 As to the compatibility with A1P1 of a new scheme, Counsel has advised that such a scheme might be compatible with A1P1.

| In my view, different considerations would apply in terms of compatibility with A1P1 if the Government's purpose in introducing such a new scheme was the creation of a more accurate method of identifying lower value properties and providing leaseholders of such properties with a more favourable basis of valuation, rather than the Government's purpose being to simplify the complexities of section 9(1). If the Government made the assessment (supported by evidence) that leaseholders of low value properties require additional assistance to enable them to enfranchise (for example, because they are less likely to be able to afford to enfranchise even in respect of a low value property), and the Government's aim in introducing the scheme was to assist such leaseholders to enfranchise, then the Courts are likely to find that the scheme pursues a legitimate aim in the public interest (as the ECtHR did in James v UK). Provided the scheme accurately applies to all and only low value properties, it would be impossible to attack the scheme as arbitrary, irrational or as failing to achieve its designed purpose. The only question would be whether it strikes a fair balance in terms of compensation payable to landlords. If the premiums payable to landlords under |

243
the new scheme are no lower than those currently payable under section 9(1), then I consider that any such new scheme is marginally more likely than not to be compatible with A1P1. In other words, I would assess the risk of a successful A1P1 challenge to such a scheme as slightly less than 50% i.e. towards the upper end of Medium Low.

9.151 In terms of what should happen to section 9(1) in the event that a new scheme is introduced, Counsel has advised that the adoption of either option 1 or 2 (in paragraph 9.144 above) is unlikely to affect her risk assessment.

The A1P1 risk assessment is unlikely to be significantly affected by the manner in which the new scheme is introduced. What is likely to matter more is whether Parliament takes sufficient time to consider the aims and ambit of the scheme and particularly to consider the impact of the scheme on landlords (as well as leaseholders). I consider it would be open to the Government to abolish section 9(1) and introduce the new scheme with immediate effect, without affecting the A1P1 risk assessment. I also consider it is unlikely to affect the risk assessment to retain section 9(1) for a temporary period, at the same time as introducing the new scheme. Although this would introduce a disparity between leaseholders of existing and new leases which are of equal value, this would be temporary, and could probably be justified on the basis that it would allow leaseholders who currently qualify for a section 9(1) valuation but would not qualify under the new scheme (or who qualify under both section 9(1) and the new scheme but would have to pay an increased premium under the new scheme) the opportunity to take the benefit of section 9(1) while it remained in force.

9.152 As we note above, however, Counsel considers that any proposal to retain section 9(1) indefinitely alongside a new scheme would increase the risk of a successful challenge to a new scheme on A1P1 grounds and accordingly, this is not an option that we put forward for Government.

However, I have more concern about any proposal to retain section 9(1) indefinitely alongside a new scheme. This would appear to have less justification than a sunset provision, as it would create a long-term disparity between leaseholders of existing and new leases which are of equal value for no obvious reason. It is also likely to increase the risk of a successful challenge to the section 9(1) basis of valuation, because it is harder to justify retaining a potentially flawed scheme indefinitely alongside a new scheme which was intended to remedy those flaws. I estimate that the risk of a successful A1P1 challenge in these circumstances would be Medium High.

Option 15.

9.153 Government could:

(1) retain section 9(1) in its current form with or without prescribing rates; or
(2) replace section 9(1) with an entirely new scheme providing a favourable valuation for low value properties and either (a) abolish section 9(1) immediately or (b) retain section 9(1) temporarily for a sunset period.
Chapter 10: Summary of options to reduce premiums

CHAPTER 5: POSSIBLE NEW VALUATION “SCHEMES” TO REDUCE PREMIUMS

Option 1
10.1 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is not in the market and will never be in the market (which we call “Scheme 1”). The scheme would reduce premiums for leaseholders with 80 years or less left to run by removing the requirement to pay marriage value. Scheme 1 could also reduce premiums for leaseholders of any lease length, if combined with other reforms outlined in Chapter 6 of this Report.

[Paragraph 5.109]

Option 2
10.2 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is not in the market but may be in the market in the future (which we call “Scheme 2”). The scheme would reduce premiums for leaseholders with 80 years or less left to run by removing the requirement to pay marriage value and replacing it with a requirement to pay hope value (which is less than marriage value). Scheme 2 could also reduce premiums for leaseholders of any lease length, if combined with other reforms outlined in Chapter 6 of this Report.

[Paragraph 5.119]

Option 3
10.3 Government could adopt an overall valuation regime in which it is assumed that the leaseholder is always in the market (which we call “Scheme 3”). The scheme would only have the effect of reducing premiums if combined with other reforms outlined in Chapter 6 of this Report.

[Paragraph 5.123]

Option 4
10.4 As well as selecting Scheme 1, 2 or 3 as an overall valuation regime, if Government wishes to prescribe rates (see Option 7 below,\textsuperscript{217} which we call “Sub-option 1”) and introduce an online calculator (see Option 14 below),\textsuperscript{218} it must also require the

\textsuperscript{217} Para 10.9.

\textsuperscript{218} Para 10.18 and 10.19.
conventional valuation methodology (and no other alternative methodology) to be used for the valuation of enfranchisement premiums under that Scheme.

[Paragraph 5.124]

Option 5

10.5 As a mechanism to implement Schemes 1, 2 or 3 as a new overall valuation regime, particular categories of lease could be identified for which enfranchisement premiums could be calculated by using a ground rent multiplier or a capitalised ground rent.

10.6 But such an approach would introduce complexity and potential confusion by creating different valuation mechanisms for different types of lease, all of which ultimately achieve the same result.

[Paragraph 5.133 and 5.134]

Option 6

10.7 If the existing valuation regime is maintained, Government could nevertheless create a simple formula – such as a ground rent multiplier, a capitalised ground rent, or a percentage of freehold value – that would apply to a limited category of leases.

10.8 But if rates are prescribed and an online calculator is introduced, such a scheme would be unnecessary.

[Paragraphs 5.139 to 5.140]

CHAPTER 6: “SUB-OPTIONS” FOR A NEW SCHEME TO REDUCE PREMIUMS

Option 7

10.9 Capitalisation rates, deferment rates, and relativity (or a no-Act deduction) could all be prescribed by the Secretary of State and/or Welsh Ministers, after taking advice from a representative body of experts (which we refer to as “Sub-option 1”). Those rates could be prescribed:

(1) at market levels; or

(2) at below-market levels, in order to reduce premiums for leaseholders.

[Paragraph 6.115]

Option 8

10.10 To reduce premiums for leaseholders with onerous ground rents, the level of ground rent that is taken into account in calculating enfranchisement premiums could be capped at 0.1% of the freehold value of the property (which we refer to as “Sub-option 2”).

10.11 An exception would be necessary for leases for which (a) no premium, or (b) a premium which is indisputably less than market value, has been paid.

[Paragraphs 6.153 to 6.154]
Option 9
10.12 When exercising enfranchisement rights, and in order to reduce the premium payable where there is development value, leaseholders could be given the ability to elect to take a restriction on future development of the property (which we refer to as “Sub-option 3”).

[Paragraph 6.179]

Option 10
10.13 Despite its drawbacks, Government could reduce premiums for leaseholders who are owner-occupiers (and not for investors), in particular in order to justify the reduction under A1P1 (which we refer to as “Sub-option 4”).

[Paragraph 6.204]

Option 11
10.14 The 80-year cut-off should be retained, otherwise premiums will increase for some leaseholders. It might be possible, however, for Government to remove the cut-off as part of a package of reforms that would reduce premiums overall (which we refer to as “Sub-option 5”).

[Paragraph 6.222]

Option 12
10.15 The discount for leaseholders’ improvements should be retained (and applied at the election of the leaseholder where appropriate), otherwise premiums will increase for some leaseholders. Government could, however, remove or limit the discount in order to reduce disputes, as part of a package of reforms that would reduce premiums overall (which we refer to as “Sub-option 6”).

10.16 The discount could be simplified so that the improvements themselves are disregarded, rather than their value.

[Paragraphs 6.248 to 6.249]

Option 13
10.17 The discount for holding over should be retained (and applied at the election of the leaseholder where appropriate), otherwise premiums will increase for some leaseholders. Government could, however, remove, limit or prescribe the discount in order to reduce disputes, as part of a package of reforms that would reduce premiums overall (which we refer to as “Sub-option 7”).

[Paragraph 6.268]
CHAPTER 7: WORKING TOWARDS AN ONLINE CALCULATOR

Option 14

10.18 If rates are prescribed (see Option 7 above,\textsuperscript{219} which we call “Sub-option 1”) and the conventional valuation methodology is mandated in all cases (see Option 4 above),\textsuperscript{220} an online calculator could be introduced in order to tell leaseholders and landlords what the enfranchisement premium in a given case will be.

10.19 Once the freehold (FHVP) value of the property has been agreed between the parties or determined by the Tribunal, the online calculator could generate the precise enfranchisement premium. In rarer cases where additional value or other loss is payable, an online calculator could not generate the additional sum payable but could refer leaseholders to the possibility of this further sum being payable.

[Paragraphs 7.36 to 7.37]

CHAPTER 9: SECTION 9(1) VALUATIONS

Option 15

10.20 Government could:

(1) retain section 9(1) in its current form with or without prescribing rates; or

(2) replace section 9(1) with an entirely new scheme providing a favourable valuation for low value properties and either (a) abolish section 9(1) immediately or (b) retain section 9(1) temporarily for a sunset period.

[Paragraph 9.153]

\textsuperscript{219} Para 10.9.

\textsuperscript{220} Para 10.4.
# Appendix 1: List of consultees

| 1 West India Quay Residents’ Association         | Andrea Leech          | Anthony Kent          |
| A L Knowles                                      | Andrea Manzini        | Anthony Shamash       |
| Aaron [no other name given]                      | Andrea McKie          | Anthony Shilson       |
| Aasim Afzal                                      | Andrea Millward       | Anthony Wood          |
| Adam Stamboulid                                  | Andrew Athey          | Anton Schwarzin       |
| Adi [no other name given]                        | Andrew Baker          | Antonio De Gouveia    |
| Adlington Property Limited                       | Andrew Boorman        | Apex Housing Group    |
| Adrian Page                                      | Andrew Brophy         | ARCO (Associated     |
| Afzal Memon                                      | Andrew Callan         | Retirement Community |
| Agnes Kory                                       | Andrew Childs         | Operators)            |
| Aiton Marr                                       | Andrew Dunn           | Asela Kuruwita        |
| Alan Davies                                      | Andrew Henderson      | Arachchilage          |
| Alan Davis                                       | Andrew Pridell Associates Ltd | Ashley Hill |
| Alan Henry Brook                                 | Andrew Richard Perrin | Association of British Insurers |
| Alan Riggs                                       | Andrew Strain         | Avril Pino            |
| ALEP (Association of Leasehold Enfranchisement Practitioners) | Andrew Yelland      | Barbara Warburton     |
| Alexia Dempsey                                   | Angela Capper         | Barry Carpenter       |
| Alexis Kakoullis                                 | Angela Doran          | Barry Evans           |
| Alice Brown                                      | Angela Whitehead      | Barry McNorton        |
| Alison Rowe                                      | Anita [no other name given] | Barry Stock |
| Alison Rowlands                                  | Ann Middleton         | Belwood Court         |
| Altaf Sumra                                      | Ann Redshaw           | (Maintenance) Limited |
| Alun Gruffydd Phillips                           | Anna Jones            | Beata Baryla          |
| Alun Phillips                                    | Anna Symonowicz       | Belgravia Residents   |
| Amanda Khan                                      | Anna Williams         | Association           |
| Amanda Murphy                                    | Annabella Louise Scoffin | Belmont Park Close, |
| Amanda Whitenstall                               | Anne Heelan           | Belmont Park and Brandram |
| Amar Kansal                                      | Anne Hunter           | Road, Lewisham, London |
| Amarjit [no other name given]                    | Anne Juliff           | SE13 Leaseholders     |
| AML Surveys and Valuation Ltd                    | Annmarie O'Brien      | Benjamin Newton       |
| Amy Pegnam                                       | Anthony and Lynn Cotterill | Bert Lourenco |
| AnchorHanover                                    | Anthony Baker         | Beth Leahy            |
| Andrea Carr                                      | Anthony Brunt         | Beth Rudolf           |
|                                                    | Anthony Cummiskey     | Beverley Woodward     |
|                                                    | Anthony Hurndall      | Bi-Borough Woodward   |
|                                                    |                         | for Westminster and   |
|                                                    |                         | Kensington and Chelsea|
|                                                    |                         | Bikrish Amatya        |
|                                                    |                         | Birmingham Law Society|
Hannah Kopel
Hannah Yates
Hatal Raninga
Hayes Point Collective Freehold Limited
Heather Keates
Hele Meehan
Helen Atack
Helen Butcher
Helen Leighton
Helen Merrifield
Helen Short
Hilary McDonagh
Hitesh Sangtani
Howard de Walden Estates Limited
Hugh Donaldson
Huw Thomas
Iain Glennon
Ian Ashmore
Ian Daniels
Ian Grant
Ian Holland
Ian Humphreys
Ian Jefferson
Ian Kirby
Ian Leigh
Ian Morgan
Ian Murphy
Ian Nicholson
Ian Teacher
Ian Thomson
Ian Young
Institute and Faculty of Actuaries (IFoA)
Irwin Mitchell LLP
J Walsh
J Williams
Jacob Fraser
Jacqueline Coals
Jacqueline Perkins
Jad Adams
Jahangir Hussain
James Driscoll
James Matthews
James Mills
James Moyse
James Pickering
James Souter
James Strong
James T Palmer
Jamie Farrell
Jamie John Atkins
Janaka Prasad Vithanage
Janan Shan
Jaqueline Gay Meeks
Jasmin Akhtar
Jason Smith
Jay Beeharry
Jayne Field
Jean Lemon
Jeanette [no other name given]
Jeanette Allen
Jeanette Rodgers
Jean-Sebastien Tourtel
Jeffrey Ellis
Jennifer Ellis
Jennifer McMaster
Jenny Harley
Jeremy Gibbs
Jeremy Goldberg
Jeremy Shall
Jerry and Tamzin Mannion
JLL
Jo Darbyshire
Jo Morgan
Joan Bingham
Joanne Walker
Jocelyn [no other name given]
John Bound
John Byers
John Davidson
John Fosyer
John Fryer
John Hall
John Hammerbeck
John Lyon's Charity
John Paul Hardesty
John Rogers
John Shorrock
John Smyth
John Stephenson
John W Bunting
Jonathan Adams
Jonathan and Yvonne Boyd
Jonathan Clark
Jonathan Grisenthwaite
Jonathan King
Jonathan Poulter
Jonathan Pringle
Jonathan Rolls
Jonathan West
Joseph McGuigan
Josephine Rostron
Joy Dickinson
Judith Read
Julian E C Briant
Julian Parsons
Julian Wilkins & Co Chartered Surveyors
Jupiter Investments Ltd
Kalpesh Patel
Kapil Purohit
Karen Burrell
Karen Conneely
Karen Deakin
Karen Knowles
Karen Mills
Karen Wilson
Martin Beesley
Martin Chamberlain
Martin Cottam
Martin Dawson
Martin Geoghegan
Martin William D T Ward
Martine Colby
Martyn Eynon Jones Not applicable
Mary Stiff
Matthew Alton
Matthew Hewstone
Matthew McKay
Matthew Olley
Maureen Gillooly
Maureen Whitlock
Mavis Chakwenya
Mavis Paterson
Max Beckett
Mayoor Agarwal
Mayor of London
McCarthy & Stone
Megan Bowyer
Mehboob Neky
Melanie West
Melissa Goodwin
Melissa Johnson
Michael Hollands
Michael Huang
Michael Kelly
Michael Kucharski
Michael Marshall
Michael Moran
Michalis Kapsos
Michelle Merrilees
Midland Valuations Limited
Mike [no other name given]
Mike Searle
Millbrooke Court Residents Association
Miss J Boyce and Mr Mark Mitchell
Mitchell [no other name given]
Morgoed Estates Limited
myleasehold ltd
Nagappan Selvan
Nancy Hopkins
Nasir Zaman
Natalia Bremer
Natalie Suggitt
Natasha Forster
Natasha Sampson
National CLT Network and
the UK Cohousing Network
National Housing Federation
National Leasehold Campaign
National Trust
Neil Gear
Nesbitt and Co
Neville Brian Gallacher
Nicholas Roberts
Nick Raymond
Nick Steel
Nick Trainer
Nicola Beswick
Nicola Bowden
Nicola Callaghan
Nicola Jenkinson
Nicola Jones
Nicola Reid
Nicola Smith
Nicola Tann
Nicola Tomlinson
Nicola Warburton
Nigel Carrie
Nigel Edwards
Nigel Keen
Nina Rautio
Nina Salsotto Cassina
North View Fold Resident Group
Notting Hill Genesis
Oakfield Court Residents' Association
Octavia Housing
Oliver Stancombe
Onward Homes
Orme Associates Property Advisers
Ormond P Simpson
Owen O'Neill
Pamela Cunliffe
Pamela Rose
Parthenia
Patricia Kennedy
Paul and Sally Coulthard
Paul Church
Paul Glover
Paul Goodlad
Paul Gothard
Paul Hamilton
Paul Hird
Paul Osborne
Paul Potts
Paul Roberts
Paul Rowntree
Paul Tayler Limited
Paul Thomas
Paul Thurston
Paul Willmott
Paul Worley
Paula Hill
Paula Shaw
Pauline Mawer
PBM Property Management
Pearn Ltd
Penelope Brook
Pennington Manches LLP
Penny Atkinson
Penny Gell
<table>
<thead>
<tr>
<th>Name</th>
<th>Name</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Persimmon plc</td>
<td>Residents’ Association of Canary Riverside</td>
<td>Russell Thomson</td>
</tr>
<tr>
<td>Pete Liggins</td>
<td>Rhett Ewer</td>
<td>S M Rendell</td>
</tr>
<tr>
<td>Peter and Christine Davis</td>
<td>Richard Baron</td>
<td>Salah Banna</td>
</tr>
<tr>
<td>Peter Barker</td>
<td>Richard Bass</td>
<td>Sally Jane Jenkins</td>
</tr>
<tr>
<td>Peter Beckett</td>
<td>Richard Chester</td>
<td>Sally Mills</td>
</tr>
<tr>
<td>Peter Cunningham</td>
<td>Richard Glass</td>
<td>Sandeep Dulai</td>
</tr>
<tr>
<td>Peter Finneran</td>
<td>Richard Hards</td>
<td>Sandra Smith</td>
</tr>
<tr>
<td>Peter Jones and Gabrielle Maxwell-Jones</td>
<td>Richard Hartigan</td>
<td>Sanja Williams</td>
</tr>
<tr>
<td>Peter Muir</td>
<td>Richard McCarthy</td>
<td>Sara Cornthwaite</td>
</tr>
<tr>
<td>Peter Weeks</td>
<td>Richard Porter</td>
<td>Sarah Brachtvogel</td>
</tr>
<tr>
<td>Peter Wright</td>
<td>Richard Stacey</td>
<td>Sarah Chan</td>
</tr>
<tr>
<td>Philip Ashley</td>
<td>Richard Warwick</td>
<td>Sarah Cooper</td>
</tr>
<tr>
<td>Philip Bullivant</td>
<td>Richard William Morris</td>
<td>Sarah Elise Robertson</td>
</tr>
<tr>
<td>Philip Cross</td>
<td>Rishi Mital</td>
<td>Sarah Foster</td>
</tr>
<tr>
<td>Philip Culley</td>
<td>Rita Simmonds</td>
<td>Sarah Hilton</td>
</tr>
<tr>
<td>Philip Kelly</td>
<td>Robert Bater</td>
<td>Sarah Johnston</td>
</tr>
<tr>
<td>Philip Rainey QC</td>
<td>Robert Brooks</td>
<td>Sarah Majid</td>
</tr>
<tr>
<td>Phyllis Helen Buchanan</td>
<td>Robert Guerrini</td>
<td>Sarah Webb</td>
</tr>
<tr>
<td>Piers Haben</td>
<td>Robert James</td>
<td>Sarfraz Rajwadkar</td>
</tr>
<tr>
<td>Polly Durey</td>
<td>Robert Nix</td>
<td>Sarum St Michael Management Company Ltd</td>
</tr>
<tr>
<td>Pollyanna Williams</td>
<td>Robert Owen</td>
<td>Saul Gerrard</td>
</tr>
<tr>
<td>Professor Grey Giddins</td>
<td>Robert Parr</td>
<td>Sayyam Sahni</td>
</tr>
<tr>
<td>Property Bar Association</td>
<td>Robert Warren</td>
<td>Scrivener Tibbatts Ltd</td>
</tr>
<tr>
<td>Prosper Marr-Johnson</td>
<td>Robert Wood</td>
<td>Sharon Johnson</td>
</tr>
<tr>
<td>Rachael Ball</td>
<td>Robin Benjamin</td>
<td>Shaun Porter</td>
</tr>
<tr>
<td>Rachael Newman</td>
<td>Roger Dunn</td>
<td>Sheila Jalving</td>
</tr>
<tr>
<td>Rachel Florey</td>
<td>Roger Parkin</td>
<td>Sheila Neville</td>
</tr>
<tr>
<td>Rachel Lewin</td>
<td>Rolfe Klement</td>
<td>Sheila White</td>
</tr>
<tr>
<td>Rachel Rose Dring</td>
<td>Ron Harris</td>
<td>Shelagh Fitzpatrick</td>
</tr>
<tr>
<td>Radamanthos Tsotsos</td>
<td>Rory &amp; Elizabeth Cunningham</td>
<td>Shelley King</td>
</tr>
<tr>
<td>Rakesh Tiwari</td>
<td>Rory Cunningham</td>
<td>Shepard Way Residents Association</td>
</tr>
<tr>
<td>Rama Vorray</td>
<td>Rosemary Hadfield</td>
<td>Shira Baram</td>
</tr>
<tr>
<td>Ramilla Shah</td>
<td>Rosie Bahr</td>
<td>Shirley Mcdonagh</td>
</tr>
<tr>
<td>Randy Silver</td>
<td>Rothesay Life</td>
<td>Shoosmiths LLP</td>
</tr>
<tr>
<td>Ravelle Josephs</td>
<td>Royal Institution of Chartered Surveyors (RICS)</td>
<td>Simon Davies</td>
</tr>
<tr>
<td>Ray Chapple</td>
<td>Rupert Barnes</td>
<td>Simon Davies</td>
</tr>
<tr>
<td>Renate Thompson</td>
<td>Rupert Houlbty</td>
<td>Simon Elliott</td>
</tr>
<tr>
<td>Resident Landlords Association</td>
<td>Russell Hughes</td>
<td>Simon Wones</td>
</tr>
</tbody>
</table>
Appendix 2: Terms of Reference

THE LAW COMMISSION: RESIDENTIAL LEASEHOLD LAW REFORM

TERMS OF REFERENCE

The project was announced in the Law Commission's *Thirteenth Programme of Law Reform* and in Government's response to its consultation *Tackling unfair practices in the leasehold market*.

The project will be a wide-ranging review of residential leasehold law, focussing in the first instance on reform to:

1. enfranchisement;
2. commonhold; and
3. the right to manage.

The Commission and Government are discussing other areas of residential leasehold reform that could be included in the project.

The Government has identified the following policy objectives for the Law Commission's recommended reforms:

**Generally**

- to promote transparency and fairness in the residential leasehold sector;
- to provide a better deal for leaseholders as consumers;

**Enfranchisement**

- to simplify enfranchisement legislation;
- to consider the case to improve access to enfranchisement and, where this is not possible, reforms that may be needed to better protect leaseholders, including the ability for leaseholders of houses to enfranchise on similar terms to leaseholders of flats;
- to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise, whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests;
- to make enfranchisement easier, quicker and more cost effective (by reducing the legal and other associated costs), particularly for leaseholders, including by introducing a clear prescribed methodology for calculating the premium (price), and by reducing or removing the requirements for leaseholders (i) to have owned their lease for two years before enfranchising, and (ii) to pay their landlord's costs of enfranchisement;
• to ensure that shared ownership leaseholders have the right to extend the lease of their house or flat, but not the right to acquire the freehold of their house or participate in a collective enfranchisement of their block of flats prior to having "staircased" their lease to 100%; and

• to bring forward proposals for leasehold flat owners, and house owners, but prioritising solutions for existing leaseholders of houses;

Commonhold
• to re-invigorate commonhold as a workable alternative to leasehold, for both existing and new homes.

Right to manage
• to facilitate and streamline the exercise of the right to manage.

(1) ENFRANCHISEMENT

Enfranchisement covers the statutory right of leaseholders to:

• purchase the freehold of their house;

• participate, with other leaseholders, in the collective purchase of the freehold of a group of flats; and

• extend the lease of their house or flat.

The project will consider the following issues:

1. Qualifying criteria. The Commission will review the qualifying criteria that must be satisfied to exercise the right to enfranchise, namely:

   a. the premises that qualify for enfranchisement;

   b. the leaseholders who can exercise the rights, including the two-year ownership requirement, and the proportion of tenants required to participate in a collective enfranchisement claim;

   c. the landlords to whom the enfranchisement legislation applies; and

   d. the leases to which the enfranchisement legislation applies.

2. Valuation. The Commission will seek to produce options for a simpler, clearer and consistent valuation methodology. The review will include consideration of:

   a. the existing valuation assumptions;

   b. the extent to which the ground rent (including any rent review clause) should feature in the valuation;

   c. the role of yield and deferment rates and whether they could be standardised;
d. the role of marriage value, hope value, and relativity, and the extent to which they should feature in the valuation;

e. whether to retain different valuation bases (as currently exist for enfranchisement of houses, depending on historic rateable values);

f. the valuation of the interest of any intermediate leaseholders.

3. **Procedure.** The Commission will consider reforms to make it easier, quicker and more cost effective to enfranchise. The review will include consideration of:

   a. introducing a simplified enfranchisement procedure which is, so far as possible, consistent across all enfranchisement claims;

   b. the form, content, effect, service, and assignment of notices by leaseholders and landlords in the enfranchisement process;

   c. how to reduce or remove the requirement for leaseholders to be responsible for landlords’ costs of responding to enfranchisement claims;

   d. the nature and role of the nominee purchaser in collective enfranchisement claims;

   e. giving effect to the right to enfranchise, including the conveyancing procedure, the terms of the transfer of the freehold or extended lease, leasebacks to the landlord, and the role of third party funders (in a collective enfranchisement claim);

   f. the forum for, and facilitation of, the resolution of disputes and enforcement of the statutory rights;

   g. problems that arise where there are missing, incapacitated, recalcitrant, or insolvent landlords; and

   h. the termination or suspension of an enfranchisement claim, and its effect.

(2) **COMMONHOLD**

Commonhold is a form of ownership of land which is designed to enable the freehold ownership of flats. There are various legal issues within the current commonhold legislation which affect market confidence and workability. The Commission will review those issues to enable commonhold to succeed.

The following legal issues will be considered:

1. **Creation of commonhold (including conversion).** The Commission will consider whether the procedure for creating and registering commonhold could be simplified and how it could be made easier for leaseholders to convert. In particular, the Commission will review whether, and if so how, it might be possible to convert to commonhold without the consent of:

   a. the freeholder; and
b. all of the leaseholders.

2. **Improving flexibility.** The Commission will consider reforms to make the commonhold model more sophisticated and flexible to meet the needs of communities and developers, including:

   a. the creation of “layered” or “sub-commonholds” to deal with different parts of a commonhold scheme, especially in mixed-use developments; and

   b. allowing different costs to be shared between unit-holders in ways that will better reflect actual use of amenities and services.

3. **Corporate structure.** The Commission will consider whether the commonhold association, which owns and manages the common parts of the commonhold, should remain a company limited by guarantee or whether there might be a more appropriate corporate structure.

4. **Shared ownership.** The Commission will consider ways of incorporating shared ownership within commonhold.

5. **Developer rights and consumer protection.** Ensuring developers have sufficient power to complete the development whilst affording protection to unit-holders.

6. **Commonhold Community Statement.** The Commission will review the model CCS which sets out the rights and obligations of unit-holders and the commonhold association. In particular, the Commission will seek to ensure the CCS is flexible enough to meet the local needs of a scheme, and consider the circumstances in which it can be varied.

7. **Dispute resolution.** The Commission will consider ways of facilitating the resolution of disputes within commonhold.

8. **Enforcement powers.** The Commission will consider whether the enforcement powers of the commonhold association, for instance to enforce the payment of commonhold costs, are sufficient or whether these powers should be enhanced. The Commission will also consider whether there are sufficient safeguards in place to protect unit-holders from unreasonable demands for costs.

9. **Insolvency.** The Commission will consider whether any mechanisms could usefully be put in place to prevent a commonhold association from becoming insolvent, for instance whether it might be appropriate for an administrator to be appointed. The Commission will also consider the effect of insolvency on a commonhold association and review whether homeowners and lenders are adequately protected.

10. **Voluntary termination.** The Commission will review the procedure for the termination of a commonhold association by unit-holders and consider whether lenders’ security is adequately protected.

The project will commence with the publication of a call for evidence. Other legal problems that emerge from that call for evidence will be included in the project by agreement with Government.

The Commission’s review will complement Government’s own work to remove incentives to use leasehold, and Government’s work to address non-legal issues to re-invigorate
commonhold such as education, publicity and supporting developers, lenders and conveyancers. As part of its call for evidence, the Commission will invite consultees’ views on (i) whether, and if so how, commonhold should be incentivised or compelled, and (ii) the non-legal issues that must be addressed to re-invigorate commonhold, and report on the outcome of that consultation, without making recommendations.

(3) RIGHT TO MANAGE

The right to manage was introduced by the Commonhold and Leasehold Reform Act 2002. It is a right granted to leaseholders to take over the landlord’s management functions through a company set up by the leaseholders for this purpose.

The Law Commission is asked to conduct a broad review of the existing right to manage legislation with a view to improving it. In particular, the Law Commission will:

1. consider the use currently made of the right to manage legislation and how far it meets the needs of users;

2. consider the case to improve access to the right to manage, including by modifying or abolishing existing qualification criteria; and

3. make recommendations to render the right to manage procedure simpler, quicker and more flexible, particularly for leaseholders.
Appendix 3: Calculations of premiums for the worked examples (Houses 1 to 4)

INTRODUCTION

3.1 In Figure 3, at paragraph 2.2 above, we set out four examples of houses to which we then refer throughout the rest of this Report. Those examples were as follows.

<table>
<thead>
<tr>
<th>House 1:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value on a freehold basis: £250,000</td>
</tr>
<tr>
<td>Valuation date: 2019</td>
</tr>
<tr>
<td>Details of existing lease:</td>
</tr>
<tr>
<td>Granted in 1995 for 125 years</td>
</tr>
<tr>
<td>Unexpired term: 101 years</td>
</tr>
<tr>
<td>Value of lease: £245,000</td>
</tr>
<tr>
<td>After freehold purchase:</td>
</tr>
<tr>
<td>No lease</td>
</tr>
<tr>
<td>No ground rent</td>
</tr>
<tr>
<td>Value of freehold: £250,000</td>
</tr>
<tr>
<td>Ground rent: £50 per annum, increasing by £50 every 25 years:</td>
</tr>
<tr>
<td>- £50 per annum from 1995</td>
</tr>
<tr>
<td>- £100 per annum from 2020</td>
</tr>
<tr>
<td>- £150 per annum from 2045</td>
</tr>
<tr>
<td>- £200 per annum from 2070</td>
</tr>
<tr>
<td>- £250 per annum from 2095</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value on a freehold basis: £250,000</td>
</tr>
<tr>
<td>Valuation date: 2019</td>
</tr>
<tr>
<td>Details of existing lease:</td>
</tr>
<tr>
<td>Granted in 1995 for 100 years</td>
</tr>
<tr>
<td>Unexpired term: 76 years</td>
</tr>
<tr>
<td>Value of lease: £226,250</td>
</tr>
<tr>
<td>After freehold purchase:</td>
</tr>
<tr>
<td>No lease</td>
</tr>
<tr>
<td>No ground rent</td>
</tr>
<tr>
<td>Value of freehold: £250,000</td>
</tr>
<tr>
<td>Ground rent: £50 per annum, increasing by £50 every 25 years:</td>
</tr>
<tr>
<td>- £50 per annum from 1995</td>
</tr>
<tr>
<td>- £100 per annum from 2020</td>
</tr>
<tr>
<td>- £150 per annum from 2045</td>
</tr>
<tr>
<td>- £200 per annum from 2070</td>
</tr>
</tbody>
</table>

---

221 Existing lease value is based on guidance in *Contractreal Ltd v Smith* [2017] UKUT 178 (LC), at [70], and *Earl Cadogan v Erkman* [2011] UKUT 90 (LC).

222 Existing lease value is based on the Gerald Eve 1996 graph of unenfranchiseable relativities, available at www.geraldeve.com/services/leasehold-enfranchisement.
House 3:

Value on a freehold basis: £250,000  
Valuation date: 2019

Details of existing lease: After freehold purchase:
Granted in 2010 for 250 years  
Unexpired term: 241 years  
Value of lease: £247,500223  
Value of freehold: £250,000

Ground rent:
- £300 per annum, increasing in line with the 
  Retail Prices Index ("RPI") every 10 years

House 4:

Value on a freehold basis: £250,000  
Valuation date: 2019

Details of existing lease: After freehold purchase:
Granted in 2010 for 250 years  
Unexpired term: 241 years  
Value of lease: £247,500224  
Value of freehold: £250,000

Ground rent:
- £300 per annum doubling every 10 years  
  for 50 years

3.2 In this Appendix, we explain in more detail the calculations behind determining the 
enfranchisement premiums for each house. The final enfranchisement premium for 
each house is as follows (as set out in Figure 9; para 2.54).

(3) House 1: £4,147.

(4) House 2: £16,453.

(5) House 3: £9,557.


223 Existing lease value is based on guidance in Contractreal Ltd v Smith [2017] UKUT 178 (LC), at [70], and 
Earl Cadogan v Erkman [2011] UKUT 90 (LC). If the lease was under 80 years, and marriage value payable, 
it would be subject to an onerous ground rent adjustment. See further n 44 above.

224 Existing lease value is based on guidance in Contractreal Ltd v Smith [2017] UKUT 178 (LC), at [70], and 
Earl Cadogan v Erkman [2011] UKUT 90 (LC). If the lease was under 80 years, and marriage value payable, 
it would be subject to an onerous ground rent adjustment. See further n 44 above.
THE TERM

3.3 In Figure 4 (para 2.27), we set out that the value of the term in respect of each of the four houses is as follows.

<table>
<thead>
<tr>
<th>Calculation of the “term” for Houses 1, 2, 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House 1:</strong> The current value of the right to receive £50 per annum rising to £250 per annum over the next 101 years of the lease based on a capitalisation rate of 6% is <strong>£1,844</strong>.</td>
</tr>
<tr>
<td><strong>House 2:</strong> The current value of the right to receive £50 per annum rising to £200 per annum over the next 76 years of the lease based on a capitalisation rate of 6% is <strong>£1,806</strong>.</td>
</tr>
<tr>
<td><strong>House 3:</strong> The current value of the right to receive £300 per annum, increasing in line with RPI every 10 years of the term, for the remaining 241 years of the lease based on a capitalisation rate of 4% is <strong>£9,554</strong>.</td>
</tr>
<tr>
<td><strong>House 4:</strong> The current value of the right to receive £300 per annum, doubling every 10 years for the first 50 years of the term, for the remaining 241 years of the lease based on a capitalisation rate of 4% is <strong>£79,422</strong>.</td>
</tr>
</tbody>
</table>

3.4 Each of the houses is taken in turn, and the calculation is explained in more detail.

<table>
<thead>
<tr>
<th>House 1:</th>
</tr>
</thead>
<tbody>
<tr>
<td>The current ground rent is £50 per annum, and it is one year until the first rent review.</td>
</tr>
</tbody>
</table>

The years’ purchase for one year, at a capitalisation rate of 6%, is 0.9434. Therefore, the value of a ground rent of £50 per annum for one year is £50 × 0.9434 = **£47**.

There will subsequently be four rent reviews, before the expiry of the lease in 101 years.

- £100 per annum from 2020
- £150 per annum from 2045
- £200 per annum from 2070
- £250 per annum from 2095

The years’ purchase for 25 years at a capitalisation rate of 6% is **12.7834**. That figure will need to be multiplied by the present value of £1 after 1, 26, 51 and 76 years at a deferment rate of 6% (which, by convention, in this context, mirrors the capitalisation rate applied) respectively, to reflect the fact that the value is being paid now, rather than in the future.

The relevant present values are as follows.

- £1 after 1 year at a deferment rate of 6% = **0.9434**.
- £1 after 26 years at a deferment rate of 6% = **0.2198**.
- £1 after 51 years at a deferment rate of 6% = **0.0512**.
- £1 after 76 years at a deferment rate of 6% = **0.0119**.

Therefore, the relevant multiplier to be applied to the rent in respect of each review period is as follows.

- In respect of the review period from 2020, \(12.7834 \times 0.9434 = \textbf{12.0598} \).
- In respect of the review period from 2045, \(12.7834 \times 0.2198 = \textbf{2.8099} \).
- In respect of the review period from 2070, 12.7834 × 0.0512 = 0.6547.
- In respect of the review period from 2095, 12.7834 × 0.0119 = 0.1525.

The value of each period of rent, and the total, is therefore as follows.

- From 2019: (as above) = £47.
- From 2020: £100 × 12.0598 = £1,206.
- From 2045: £150 × 2.8099 = £421.
- From 2070: £200 × 0.6547 = £131.
- From 2095: £250 × 0.1525 = £38.

Total value of the term in respect of House 1 is £47 + £1,206 + £421 + £131 + £38 = £1,844

House 2:

The current ground rent is £50 per annum, and it is one year until the first rent review.

The years’ purchase for one year, at a capitalisation rate of 6%, is 0.9434. Therefore, the value of a ground rent of £50 per annum for one year is £50 × 0.9434 = £47.

There will subsequently be three rent reviews, before the expiry of the lease in 76 years.

- £100 per annum from 2020
- £150 per annum from 2045
- £200 per annum from 2070

The years’ purchase for 25 years at a capitalisation rate of 6% is 12.7834. That figure will need to be multiplied by the present value of £1 at a deferment rate of 6% after 1, 26 and 51 years respectively, to reflect the fact that the value is being paid now, rather than in the future.

The relevant present values are as follows.

- £1 after 1 year at a deferment rate of 6% = 0.9434.
- £1 after 26 years at a deferment rate of 6% = 0.2198.
- £1 after 51 years at a deferment rate of 6% = 0.0512.

Therefore, the relevant multiplier to be applied to the rent in respect of each review period is as follows.

- In respect of the review period from 2020, 12.7834 × 0.9434 = 12.0598.
- In respect of the review period from 2045, 12.7834 × 0.2198 = 2.8099.
- In respect of the review period from 2070, 12.7834 × 0.0512 = 0.6547.

The value of each period of rent, and the total, is therefore as follows.

- From 2019: (as above) = £47.
- From 2020: £100 × 12.0598 = £1,206.
- From 2045: £150 × 2.8099 = £421.
- From 2070: £200 × 0.6547 = £131.

Total value of the term in respect of House 2 is £47 + £1,206 + £421 + £131 = £1,806
**House 3:**

The current ground rent is £300 per annum, and it is one year until the first rent review.

The years’ purchase for one year, at a capitalisation rate of 4%, is 0.9615. Therefore, the value of a ground rent of £300 per annum for one year is £300 \times 0.9615 = **£288**.

There will subsequently be a rent review every 10 years (until the end of the lease in 241 years), increasing the ground rent in line with RPI. The capitalisation rate that has been chosen to reflect this is 4%.

The years’ purchase for 240 years at a capitalisation rate of 4% is **24.9980**. The present value of £1 after one year at a deferment rate of 4% is 0.9615, so the multiplier to be applied to the ground rent from 2020 is 24.9980 \times 0.9615 = **24.0365**.

The figure that has been chosen to reflect a £300 ground rent increasing in line with RPI every 10 years for 240 years is **£385**.

The value of each period of rent, and the total, is therefore as follows.

- From 2019: (as above) **£288**.
- From 2020: £385 \times 24.0365 = **£9,266**.

Total value of the term in respect of House 3 is £288 + £9,266 = **£9,554**.

**House 4:**

The current ground rent is £300 per annum, and it is one year until the first rent review.

The years’ purchase for one year, at a capitalisation rate of 4%, is 0.9615. Therefore, the value of a ground rent of £300 per annum for one year is £300 \times 0.9615 = **£288**.

There will subsequently be five rent reviews, before the expiry of the lease in 241 years.

- £600 per annum from 2020
- £1,200 per annum from 2030
- £2,400 per annum from 2040
- £4,800 per annum from 2050
- £9,600 per annum from 2060

The first four rent reviews (in 2020, 2030, 2040 and 2050) are taken first.

The years’ purchase for 10 years at a capitalisation rate of 4% is **8.1109**. That figure will need to be multiplied by the present value of £1 at a deferment rate of 4% after 1, 11, 21, and 31 years respectively, to reflect the fact that the value is being paid now, rather than in the future.

The relevant present values are as follows.

- £1 after 1 year at a deferment rate of 4% = **0.9615**.
- £1 after 11 years at a deferment rate of 4% = **0.6496**.
- £1 after 21 years at a deferment rate of 4% = **0.4388**.
- £1 after 31 years at a deferment rate of 4% = **0.2965**.
Therefore, the relevant multiplier to be applied to the rent in respect of each review period is as follows.

- In respect of the review period from 2020, 8.1109 × 0.9615 = 7.7989.
- In respect of the review period from 2030, 8.1109 × 0.6496 = 5.2687.
- In respect of the review period from 2040, 8.1109 × 0.4388 = 3.5593.
- In respect of the review period from 2050, 8.1109 × 0.2965 = 2.4046.

There will then be a final rent review in 2050.

In respect of this final rent review, the years purchase for 200 years at a capitalisation rate of 4% is 24.9902. That figure will need to be multiplied by the present value of £1 at a deferment rate of 4% after 41 years, which is 0.2003. Therefore, the multiplier which needs to be applied to reflect the fact that the value is being paid now, rather than in the future, is 24.9902 × 0.2003 = 5.0050.

The value of each period of rent, and the total, is therefore as follows.

- From 2019: (as above) = £288.
- From 2030: £1,200 × 5.2687 = £6,322.
- From 2040: £2,400 × 3.5593 = £8,542.
- From 2050: £4,800 × 2.4046 = £11,542.
- From 2060: £9,600 × 5.0050 = £48,048.

Total value of the term in respect of House 4 is £288 + £4,679 + £6,322 + £8,542 + £11,542 + £48,048 = £79,422

THE REVERSION

3.5 In Figure 5 (para 2.39), we set out that the value of the reversion in respect of each of the four houses is as follows.

**Calculation of the “reversion” for Houses 1, 2, 3 and 4**

**House 1**: The current value of the right to receive £250,000 in 101 years based on a deferment rate of 4.75% is £2,303.

**House 2**: The current value of the right to receive £250,000 in 76 years based on a deferment rate of 4.75% is £7,349.

**House 3**: The current value of the right to receive £250,000 in 241 years based on a deferment rate of 4.75% is £3.

**House 4**: The current value of the right to receive £250,000 in 241 years based on a deferment rate of 4.75% is £3.
3.6 Each of the houses is taken in turn, and the calculation is explained in more detail.

<table>
<thead>
<tr>
<th>House 1:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The FHVP value of House 1 is £250,000.</td>
<td></td>
</tr>
<tr>
<td>The unexpired term of the lease is 101 years.</td>
<td></td>
</tr>
<tr>
<td>The present value of £1 in 101 years at a deferment rate of 4.75% is 0.0092. The deferment rate of 4.75% is taken from the decision in Sportelli.</td>
<td></td>
</tr>
<tr>
<td>The value of receiving the £250,000 house in 101 years is, therefore £250,000 \times 0.0092 = £2,303.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 2:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The FHVP value of House 2 is £250,000.</td>
<td></td>
</tr>
<tr>
<td>The unexpired term of the lease is 76 years.</td>
<td></td>
</tr>
<tr>
<td>The present value of £1 in 76 years at a deferment rate of 4.75% is 0.0294.</td>
<td></td>
</tr>
<tr>
<td>The value of receiving the £250,000 house in 76 years is, therefore £250,000 \times 0.0294 = £7,349.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 3:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The FHVP value of House 3 is £250,000.</td>
<td></td>
</tr>
<tr>
<td>The unexpired term of the lease is 241 years.</td>
<td></td>
</tr>
<tr>
<td>The present value of £1 in 241 years at a deferment rate of 4.75% is 0.000014.</td>
<td></td>
</tr>
<tr>
<td>The value of receiving the £250,000 house in 241 years is, therefore £250,000 \times 0.000014 = £3.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House 4:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The FHVP value of House 4 is £250,000.</td>
<td></td>
</tr>
<tr>
<td>The unexpired term of the lease is 241 years.</td>
<td></td>
</tr>
<tr>
<td>The present value of £1 in 241 years at a deferment rate of 4.75% is 0.000014.</td>
<td></td>
</tr>
<tr>
<td>The value of receiving the £250,000 house in 241 years is, therefore £250,000 \times 0.000014 = £3.</td>
<td></td>
</tr>
</tbody>
</table>
MARRIAGE VALUE

3.7 The lease over House 1 has an unexpired term of 101 years, and the leases over Houses 3 and 4 have unexpired terms of 241 years. No marriage value is payable in respect of any of these houses, therefore.

3.8 However, the lease over House 2 has an unexpired term of 76 years, which falls below the 80-year threshold set in the 1967 Act, as discussed in Chapter 2 above. The calculation of marriage value in respect of House 2 is considered below.

House 2:
As we explain in Chapter 2 above, the way to calculate marriage value is to work out the difference in the combined value of the leaseholder’s and landlord’s interests before the enfranchisement claim, compared with their combined value after the enfranchisement claim.

The “before” value:
- The lease is worth £226,250. Calculating this figure can be difficult, and is a matter of valuation judgement. For the purposes of this example, we have adopted the value of £226,250 based on a relativity (90.5%) determined by the Gerald Eve 1996 graph of unenfranchiseable relativities.
- The landlord’s interest is the value that he or she will lose on the enfranchisement claim – in other words, the term + the reversion = £1,806 + £7,349 = £9,155.
- The combined value of the leaseholder’s interest and the landlord’s interest before the enfranchisement claim is, therefore, £226,250 + £9,155 = £235,405.

The “after” value:
- The leaseholder will have the freehold of House 2, the FHVP value of which is £250,000.
- The landlord will have no interest in the property: £0.
- The combined value of the leaseholder’s interest and the landlord’s interest after the enfranchisement claim is, therefore, £250,000 + £0 = £250,000.

The “marriage value”:
The difference between the combined value before the claim (£235,405) and after the claim (£250,000) is £14,595 – this is the marriage value.

The leaseholder must pay the landlord, under the 1967 Act, 50% of that value, which comes to £7,298.
TOTAL PREMIUMS

3.9 Having made all the calculations referred to above, it is possible to work out the premium payable to exercise enfranchisement rights in respect of each of Houses 1 to 4.

**House 1:**
The total premium is the term (£1,844) + the reversion (£2,303).

= £4,147

**House 2:**
The total premium is the term (£1,806) + the reversion (£7,349) + the payable share (50%) of marriage value (£7,298).

= £16,453

**House 3:**
The total premium is the term (£9,554) + the reversion (£3).

= £9,557

**House 4:**
The total premium is the term (£79,422) + the reversion (£3).

= £79,425
Appendix 4: Section 9(1) modelling

Appendix 4 contains modelling relating to the impact on premiums of replacing the current valuation methodology in section 9(1) with a simplified, updated methodology. The modelling is referred to and summarised in paragraph 9.104 and Figure 34 above. Appendix 4 is in the following order:

(1) On the next page is the modelling provided by Gerald Eve LLP (relating to a house worth £325,000);

(2) The following pages contain modelling carried out by the Law Commission (relating to houses worth £150,000 and £2,500,000 respectively).
### LEASEHOLD REFORM ACT (as amended)

Calculation of Premium Payable for Freehold of a low value house under Section 5(2) on disposal to Suggested Alteratives

**Table 1**

<table>
<thead>
<tr>
<th>Control Section 5 Valuation Variables</th>
<th>Premium Alternative No 1</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Section 5 Valuation Variables</th>
<th>Premium Alternative No 2</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table 2

<table>
<thead>
<tr>
<th>Control Section 2 Valuation Variables</th>
<th>Premium Alternative No 1</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Section 2 Valuation Variables</th>
<th>Premium Alternative No 2</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table 3

<table>
<thead>
<tr>
<th>Control Section 3 Valuation Variables</th>
<th>Premium Alternative No 1</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Section 3 Valuation Variables</th>
<th>Premium Alternative No 2</th>
<th>Premium Difference</th>
<th>Percentage Difference against No 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital value of Ground Rent at 6% per</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Reversion to 50 year lease at 5.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Value of Freehold interest at 50 year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Value of Land at 8%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Comparison of premium (A) under section 9(1) and (B) on the basis of term plus percentage of reversion
House worth £150,000, ground rent of £35 per annum, site value: 35% of freehold value

<table>
<thead>
<tr>
<th>Term (years)</th>
<th>Valuation under section 9(1), with site value of 35%</th>
<th>Valuation based on term plus 35% of reversion</th>
<th>Difference (£)</th>
<th>Difference (%)</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>£58,350</td>
<td>£50,150</td>
<td>£8,200</td>
<td>16%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>10</td>
<td>£38,000</td>
<td>£33,250</td>
<td>£4,750</td>
<td>13%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>20</td>
<td>£23,700</td>
<td>£21,150</td>
<td>£2,550</td>
<td>11%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>30</td>
<td>£14,850</td>
<td>£13,550</td>
<td>£1,300</td>
<td>9%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>40</td>
<td>£9,400</td>
<td>£8,750</td>
<td>£650</td>
<td>7%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>50</td>
<td>£6,050</td>
<td>£5,700</td>
<td>£350</td>
<td>6%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>60</td>
<td>£3,950</td>
<td>£3,800</td>
<td>£150</td>
<td>4%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>70</td>
<td>£2,650</td>
<td>£2,600</td>
<td>£50</td>
<td>2%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>79</td>
<td>£1,950</td>
<td>£1,900</td>
<td>£50</td>
<td>3%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>80</td>
<td>£1,850</td>
<td>£1,850</td>
<td>£-</td>
<td>0%</td>
<td>Identical</td>
</tr>
<tr>
<td>90</td>
<td>£1,400</td>
<td>£1,400</td>
<td>£-</td>
<td>0%</td>
<td>Identical</td>
</tr>
<tr>
<td>100</td>
<td>£1,050</td>
<td>£1,100</td>
<td>-£50</td>
<td>-5%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>110</td>
<td>£900</td>
<td>£900</td>
<td>£-</td>
<td>0%</td>
<td>Identical</td>
</tr>
<tr>
<td>120</td>
<td>£750</td>
<td>£800</td>
<td>-£50</td>
<td>-7%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>130</td>
<td>£700</td>
<td>£700</td>
<td>£-</td>
<td>0%</td>
<td>Identical</td>
</tr>
<tr>
<td>140</td>
<td>£650</td>
<td>£650</td>
<td>£-</td>
<td>0%</td>
<td>Identical</td>
</tr>
</tbody>
</table>
Comparison of premium (A) under section 9(1) and (B) on the basis of term plus percentage of reversion

House worth £2,500,000, ground rent of £1 per annum, site value: 50% of freehold value

<table>
<thead>
<tr>
<th>Term (years)</th>
<th>Valuation under section 9(1), with site value of 50%</th>
<th>Valuation based on term plus 50% of reversion</th>
<th>Difference (£)</th>
<th>Difference (%)</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>£1,297,700</td>
<td>£1,193,300</td>
<td>£104,400</td>
<td>8%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>10</td>
<td>£839,450</td>
<td>£785,900</td>
<td>£53,550</td>
<td>6%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>20</td>
<td>£517,400</td>
<td>£494,150</td>
<td>£23,250</td>
<td>4%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>30</td>
<td>£318,950</td>
<td>£310,700</td>
<td>£8,250</td>
<td>3%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>40</td>
<td>£196,650</td>
<td>£195,350</td>
<td>£1,300</td>
<td>1%</td>
<td>Landlord receives less</td>
</tr>
<tr>
<td>50</td>
<td>£121,250</td>
<td>£122,800</td>
<td>-£1,550</td>
<td>-1%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>60</td>
<td>£74,750</td>
<td>£77,250</td>
<td>-£2,500</td>
<td>-3%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>70</td>
<td>£46,100</td>
<td>£48,550</td>
<td>-£2,450</td>
<td>-5%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>79</td>
<td>£29,850</td>
<td>£32,000</td>
<td>-£2,150</td>
<td>-7%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>80</td>
<td>£28,450</td>
<td>£30,550</td>
<td>-£2,100</td>
<td>-7%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>90</td>
<td>£17,550</td>
<td>£19,200</td>
<td>-£1,650</td>
<td>-9%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>100</td>
<td>£10,850</td>
<td>£12,100</td>
<td>-£1,250</td>
<td>-12%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>110</td>
<td>£6,700</td>
<td>£7,600</td>
<td>-£900</td>
<td>-13%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>120</td>
<td>£4,150</td>
<td>£4,800</td>
<td>-£650</td>
<td>-16%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>130</td>
<td>£2,550</td>
<td>£3,000</td>
<td>-£450</td>
<td>-18%</td>
<td>Landlord receives more</td>
</tr>
<tr>
<td>140</td>
<td>£1,600</td>
<td>£1,900</td>
<td>-£300</td>
<td>-19%</td>
<td>Landlord receives more</td>
</tr>
</tbody>
</table>