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# 10 years on the 'RICS Research Report 2009'

## Wholly Questionable or The Holy Grail?

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# RICS Research Report 2009

**It's the 10th Anniversary of the publication of this much maligned Report and it seems appropriate that on this "not" so auspicious occasion, we should stand back and review it.**

The reason for the research was to establish the basis for estimating "Marriage Value", 50% of which is payable to the Landlord by leaseholders in Statutory Lease Extensions, when the unexpired lease terms are 80 years or under.

"Marriage Value" is the enhanced value created when 2 interests are merged or partially merged. This happens when the sum of the whole thing is greater the sum of its parts.

**The best analogy I've come across is by Kate Tovey of the Oxford University Press:**

“It means that a single thing that is made of many separate parts can be more important, more useful, more beautiful, or in some other way “greater” than all of the separate parts on their own. For example, if you take all the parts of a watch and lay them out on the table, they will not tell the time the way an assembled watch does. If you take all the pieces of a flower and lay them on the ground, they will not grow and flourish the way a whole flower does.”

The greater the difference between the short lease value and the freehold value, the greater will be the "Marriage Value" and thus the premium payable is increased (until the lease length falls below 30 years, when Marriage Value starts to level off and fall). This difference is expressed as a percentage and is found by dividing the short lease value by the freehold value. This percentage is called the relativity.

Freeholders prefer a lower relativity as it means the difference between the short lease value and freehold value is greater and thus results in a higher premium. Whilst the reverse is true for leaseholders, who prefer higher relativities as it means the difference between the short lease value and the freehold value is less and results in a lower premium.

The aim of the Research Report was to provide valuers and the Tribunals with "useful guidance" to the short lease value in the absence of reliable market evidence i.e. comparables.

**The highlight of the research came in Coolrace Ltd (2012) UKUT 69 (LC) when P R Frances summarises and describes the report in the following glowing terms:**

“...the RICS Leasehold Relativities Group in October 2009 contained details of a variety of graphs prepared by surveyors and firms that act for both landlords and tenants. As such, in total, they provide a graphical analysis based upon a large number of LVT decisions, settlements and valuation opinion. Collectively, therefore, they represent the broadest currently available study relevant to the issue of relativity.”

Before I review where the Report stands today, we need to understand what lead to it in the first place.

**In Arrowdell Ltd v Coniston Court (North) Hove Ltd 2006, LRA/72/2005 George Bartlett QC and NJ Rose FRICS for the Lands Tribunal observed:**

“As we have said above, we have been acutely aware of the difficulty of reaching a satisfactory conclusion on relativity in the light of the inadequacy of the available evidence. It ought, we believe, to be possible to produce standard graphs, distinguishing between mortgage-dependant markets and those that are not so dependant, on the basis of a survey of assessments made by experienced Valuers addressing themselves properly to the hypothetical no-Act world. We express the hope that the Royal Institution of Chartered Surveyors may find itself able to carry out such an exercise and to produce guidance in the form of standard graphs that can readily be applied by Valuers in carrying out enfranchisement valuations. Such graphs could be used as evidence by LVTs, with the relativities shown being applied by them in the absence of evidence compelling the adoption of other figures.”

**It is worth noting here that the bar was not being set particularly high:**

“standard graphs...on the basis of a survey of assessments made by experienced Valuers...”

This indicates that the graphs could be made from a collection of sources which might include agreements, Tribunal decisions, market evidence and opinion, provided it came from “experienced Valuers”.

The Royal Institution of Chartered Surveyors established a working group of experienced Enfranchisement Valuers, including 7 Fellows and chaired by the barrister, Jonathon Gaunt QC, the “Leasehold Relativities Group”. Their task was to consider the above request and as a result, produced the **“RICS Research Report October 2009”**.

The report failed to reach agreement on a single graph, but instead the Report provided us with 14 graphs, split into 3 parts:

- Prime Central London (PCL) for which 6 graphs were reproduced
- Greater London and the Rest of England for which 5 graphs were reproduced
- Published research which included 3 graphs.

Whilst it wasn't the “silver bullet” that the Lands Tribunal had hoped for, it was still a useful tool for valuers as it brought all the research together under “one roof”.

It became a glorious “smorgasbord” for valuers to “pick and mix” the graphs, which in retrospect produced relativities, that were all remarkably close to each other.

In my own experience, approximately 97% of all cases were settled by negotiations within these ranges. As the graph providers represented both freeholders and leaseholders, an average of graphs produced a balance between those competing interests. It was considered by most participants to be fair.

In those rare cases which went “all the way”, the Tribunals tended to do likewise, selecting graphs that best suited the location of the property.

This proved very interesting with properties on the fringe of PCL, but just outside. The Tribunal suggested that we mix the Greater London Graphs and Prime Central London Graphs by taking for “3 for 1” in *Xue v Cherry* [2015] UKUT 651 (LC).

In *Kosta v Phillimore Estate* (2014) UKUT 0319(LC), it was decided to use the average of all RICS PCL graphs as it was agreed that a purchaser would look at all of the graphs before making a bid.

“142...However, we conclude that the successful hypothetical purchaser would be the purchaser who was prepared to base their bid upon the average of all the graphs referred to by Mr French, including the John D Wood graph, and who would in consequence outbid the more cautious potential purchaser who was only prepared to bid to the level of the average of the graphs excluding the John D Wood graph...”

# Mundy

The **Sloane Stanley Estate v Mundy (2016) UKUT 0226 (LC)** decision by **Mr Justice Morgan** and **AJ Trott FRICS** changed many of the assumptions we had made and significantly moved the goal posts.

It was only concerned with Prime Central London. We had been promised a new graph to trump all other graphs.

The drawback was that it wasn't free to use. It was to be licensed on a "pay per use basis". The new great hope for leaseholders was known as **The Parthenia Model**, as we were told it tended to favour tenants, particularly for unexpired leases less than 65 years. It was based on an analysis of **7,969 transactions** in Prime Central London from 1987 to 1991 (i.e. prior the 1993 Act ..."the No Act World"). It was possibly the biggest research into relativity ever undertaken by a single company. However, the Model was roundly rejected by the Upper Tribunal "**as the clock that struck 13**".

The Upper Tribunal went back to basic principles and stated that its preferred method of establishing relativity, is to adopt recent real-world sales and deduct for Act-rights based on experience.

This followed the advice in **Nailrile v Earl Cadogan [2009] RVR 95**, 10 years earlier. We were instructed "to do the best we can with any evidence of transactions that can usefully be applied".

However, there is limited transactional evidence of short lease sales, as most Lessees "acting prudently, knowledgeably and without compulsion", extend their lease before putting the property on the market. Therefore, we still needed to refer to Graphs of Relativity.

## Which one should we use?

**Mr Justice Morgan** and **Mr AJ Trott** were about to tell us:

That they rejected all the other Prime Central London graphs, apart from the Gerald Eve Graph, which it called "Industry Standard"...

"It is most likely that they (the market) would have referred to the GE graph first and foremost".

We were told Gerald Eve acted for freeholders in Prime Central London.

Their clients included the estates of:

- **Grosvenor**, which were retained clients since 1973
- **Cadogan** since 1976
- **Howard De Walden** since 1982
- **Ilchester** between 1992 and 2014.

Many valuers felt this graph favoured freeholders at the expense of the leaseholders, and therefore may not represent a balance.

All graphs that rely on Tribunal decisions were considered unusable. It follows a strict interpretation of the advice in **Arrowdell**:

“37.... In our judgment LVT decisions on relativity are not inadmissible, but the mere percentage figure adopted in a particular case is of no evidential value.”

However, an alternative view might have been that whilst individual decisions may not be used to set a precedent, graphs based on all Tribunal decisions rather than 1 or 2 individual decisions may be useful.

Would these collections of decisions not point to a direction of travel?

Surely Tribunals must rigorously test the evidence put before them?

Collectively, provided all decisions were used and not merely “cherry picked”, wouldn't they point to a consensus of where Relativities should be? Is it wise to rule out graphs that collate all Tribunal decisions, which are surely a useful guidance?

Graphs which have at their core opinions of leading practitioners based on a mixture of evidence, opinion, agreements and Tribunal decisions garnered from years of experience were equally dismissed, despite the stated purpose in Arrowdell, to carry out “a survey of assessments made by experienced Valuers”

**The Tribunal went on to consider that Gerald Eve was said to overstate relativities:**

“Structural changes in interest rates and rates of investment returns, changes in the nature of the market such as an influx of foreign buyers, and changes in the institutional and legal structure of the residential market all suggested that the Gerald Eve graph overstated the relative value of a lease by comparison with the value of a freehold”

**A short summary of the Upper Tribunal's position on relativity, following Mundy in Prime Central London is as follows:**

- 1. The Parthenia Model** was rejected despite it being based on an analysis of 7,969 transactions that pre-dates the 1993 Act. The main reasons given are, that interest rates have fallen since 1991 and there has been an influx of foreign investors, who take a dislike to short leases. **(Clients: Tenant)**
- 2. The John D Wood Graph** was based on over 930 settlements, Tribunal decisions and transactions. It was rejected, mainly as they had produced a later graph (the Pure Tribunal Graph) and there were some questions on their analysis, that included improvements and the treatment of onerous rent terms on some comparables. **(JDW represent mainly tenants: over 75%)**
- 3. The W.A. Ellis Graph** based on over 200 transactions analysed by the 3 partners. It was rejected, as partner views were considered to be subjective. **(Clients equally divided between Landlord and Tenant)**
- 4. The Charles Boston Graph** was based on 120 settlements. It was rejected, as reflected “personal bias”. **(Charles Boston represent mainly tenants: over 75%)**
- 5. The Cluttons Graph** was based on 400 settlements. It was rejected, as the graph is based on “a form of moving average rather than being depicted by a best fit curve”. **(Clients: Landlord)**
- 6. The Knight Frank Graph** was based on over 200 settlements, LVT and Lands Tribunal decisions. It was rejected, mainly as they have produced a later version. **(Clients: both Landlord and Tenant)**

7. The **Gerald Eve Graph** was based on over 246 settlements between 1974 and 1996 in 3 postcodes. By 2015, the settlements had grown to 3,404 but reflected no change to the graph. Considered to be “industry standard”. A Gerald Eve Partner stated that there was “no reason for relativities to have changed over time”. However, the Tribunal suggested the graph overstates relativity. **(Clients: Landlord)**
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8. **Gerald Eve** produced a new graph in 2016 (despite their previous view that relativities haven't changed). This graph is lower than their previous “Industry standard” graph. No explanation was provided as to how they arrived at this graph, but it is similar to Savills 2015. **(Clients: Landlord)**
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9. The **College of Estate Management Graph** was based on all the LVT decisions between 1994 and 1999. It was rejected, as sometimes the Tribunal “may not always produce the correct valuation”. **(Clients: Independent)**
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10. The **Savills 2002 Graph** was based on 240 open market valuations from 13 firms. It is the only graph within the RICS Research that shows relativity with Act Rights. Its influence was “waning as a result of the new emerging 2015 graph”. **(Clients: Landlord)**
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11. The **Savills 2015 Graph** was based upon analysis of 5,904 transactions between 2010 and 2015. It was the only graph, based on evidence of recent sales of flats which have Act Rights. However, it failed both the Box-Cox Test and the Ramsey Reset Test. **(Clients: Landlord)**

Only **Gerald Eve** and **Savills 2015** were deemed “useful” and Gerald Eve, we were told, had probably overstated relativity, as these graphs were the only ones relied upon in the market. Contrast the **Mundy Decision** with the view in the **Kosta Decision**, where we were told the market would have used the average of all the graphs.

It is interesting to note the **Gerald Eve Graph** is based on a small number of settlements, and no transactions (246 over a 12-year period between 1974 and 1996).

In the hierarchy of evidence, there is a preference for market evidence over settlement evidence. Yet **The Parthenia Model** which used 7,969 transactions during most of 1987 and 1991 (the same period Gerald Eve's graph was being established) has been completely rejected.

# Greater London and the Rest of England

The Upper Tribunal have more recently dealt with relativity outside Prime Central London.

**Orchidbase [2016] UKUT 0468 (LC) Case No: LRA/7/2016** concerned 3 flats in Hemel Hempstead and was heard by His Honour Judge **David Hodge QC and Peter D McCrea FRICS.**

“ We endorse and reiterate the Tribunal’s preference for market evidence over the use of relativity graphs, as long as it can be shown that the market evidence is reasonably comparable and does not require artificially extensive manipulation in order to apply it to the subject valuation.”

“ 43. In this case, we are satisfied that there is sufficient market evidence to render unnecessary any reference to graphs of relativity. Not only is there a market transaction on one of the appeal flats, there are also, fortuitously, two market transactions on very similar properties with virtually identical unexpired terms to that required to be assumed for the calculation on the appeal flats.”

The resulting relativity happened to match the **Savills 2002 Graph** with a discount for “Act Rights” in this case. However, as reported above the Tribunal relied on market evidence rather than graphs.

**Sinclair Garden Investments [2017] UKUT 0494 (LC)** concerning 2 flats in Chelmsford. The Tribunal adopted a recent short lease sale, with a “no-Act” discount, to arrive at a relativity. This figure similar to **Savills 2015 Unenfranchisable Graph.**

**Reiss v Ironhawk [2018] UKUT 0311 (LC)** concerned a flat in Tottenham.

“ It is reasonable to use the Savills’ enfranchisable graph where (i) this is broadly supported by the relativity derived from relevant market transactions and (ii) the experts have agreed the adjustment for the benefit of the Act.”

# Zucconi also known as Barrydene

The latest case involving relativity outside Prime Central London is the **Trustees of The Barry and Peggy High Foundation v Zucconi & Anor [2019] UKUT 242 (LC)** and it is arguably as much of a “gamechanger” as Mundy was for PCL.

It shows that the Upper Tribunal have “moved the goal posts” again. In this case, there was no short lease evidence. The property is located in Whetstone, 16 km north of Prime Central London. The Tribunal adopted **Savills Enfranchisable Graph** (with Act Rights) and adopted a 6% deduction for Act Rights (based upon the **Sinclair Gardens Decision [2017] UKUT 0494 (LC)**, which provided a Table of Deductions at differing lease lengths from earlier Upper Tribunal Decisions).

Gone was the previous justification that using the **Savills 2015 Graph** outside PCL, should be supported by market transactions.

This is now the point where the **Upper Tribunal** has effectively replaced the **RICS Research Report**, with **Savills Enfranchisable Graph** less the **Sinclair Gardens Discount** for “Act Rights”.

What does this mean for premiums outside PCL?

If followed, premiums outside Prime Central London increase dramatically. For example, the premium would more than double above 72 years and almost triple at 80 years.

**Here is a table showing the effect of Zucconi decision on a flat outside PCL, but with an extended Lease Value of £500,000**

Unexpired term	Pre-Zucconi RICS Average	Post Zucconi Premium	Percentage Increase by an extra
80	£11,000	£29,000	164%
75	£16,000	£38,000	138%
70	£24,000	£45,000	88%
65	£35,000	£53,000	51%
60	£46,000	£63,000	37%
55	£62,000	£75,000	21%
50	£79,000	£88,000	11%

# Is this correct or should the relativity be lower in PCL than outside?

## **Prime Central London**

This is a unique, international market with a global reputation. It contains the 5 "Great Estates": the Grosvenor, the Cadogan, the Howard De Walden, the Portman and the Bedford Estates. These estates have a renowned reputation for maintaining the value of their portfolios, by using the same experienced Valuers to negotiate higher premiums.

As a result, the relative value of short leases has been driven down by the need to pay high premiums to these estates for lease extensions. It could be argued that the market in PCL acts in a more uniform way, with monopolistic traits.

All the graphs for PCL show lower relativities than for outside PCL, where there are many more freeholders, spread out across the whole country and who do not act in a strong and unified manner.

## **Outside PCL**

Here the evidence is mixed.

There are areas where shorter leases (as low as 70 years) can sell for similar prices to longer leases. The relativity is therefore very high. The earlier Upper Tribunal cases suggest that below 70 years, the market evidence can show a lower relativity than even the average of the RICS graphs.

In my experience this is influenced by the freeholders in each location. More aggressive freeholders push premiums up which results in lower values (i.e. lower relativities) being paid for short leases, when the market is knowledgeable of the freeholder. Market evidence suggests outside PCL, relativity varies street to street and block to block.

## **Mortgageability**

Another major influencing factor is the availability of mortgage finance. While the majority of lenders accept leases down to 70 years unexpired, demand remains high. When finance options are reduced (for instance below 70 years), the demand in the market is reduced to cash buyers only.

According to the laws of supply and demand, this would tend to reduce the price paid.

Although PCL, has been described a "non-mortgage dependent market", the availability of finance must also have a role here, as not all purchases are made without finance.

My expectation for graphs of relativity would be that whilst there might be a small dip at 80 years (the point where Marriage Value is payable), I would have expected a fairly flat curve to 70 years (when mortgageability becomes an increasing factor). After this point, I would have expected a steeper curve as the demand reduces.

# Savills Enfranchisable Graph 2015

Given that the **Savills Enfranchisable Graph 2015** has just been given “Holy Grail” status by the Zucconi Judgement, is it time to review it? Is the graph a fair reflection of the market in PCL? Are the relativities in PCL, appropriate Greater London and Rest of England?

Savills publication “**Spotlight: Leasehold Enfranchisement and Analysis of Relativity**” in June 2016, brought together both the 2015 Enfranchisable Graph (used in **Mundy**) with the **2016 Unenfranchisable Graph** (based on 9 data points from earlier Upper Tribunal Decisions). We were told in **Mundy** that it “was produced specifically to be part of the Wellcome Trust’s” (the freeholder) evidence.”

**The research reviewed an impressive number of transactions:**

5,904 between January 2010 and June 2015 in Prime Central London. From this research, Savills were able to put together a graph showing actual discount the market makes for shorter leases.

**In “Mundy” the Upper Tribunal considered:**

- “... the Savills 2015 graph to be a significant improvement on its 2002 equivalent ...”
- “If there were to emerge a version of that graph, not subject to those technical criticisms, based on transactions rather than opinions, it may be that valuers would adopt that revised graph in place of the Savills 2002 graph”.

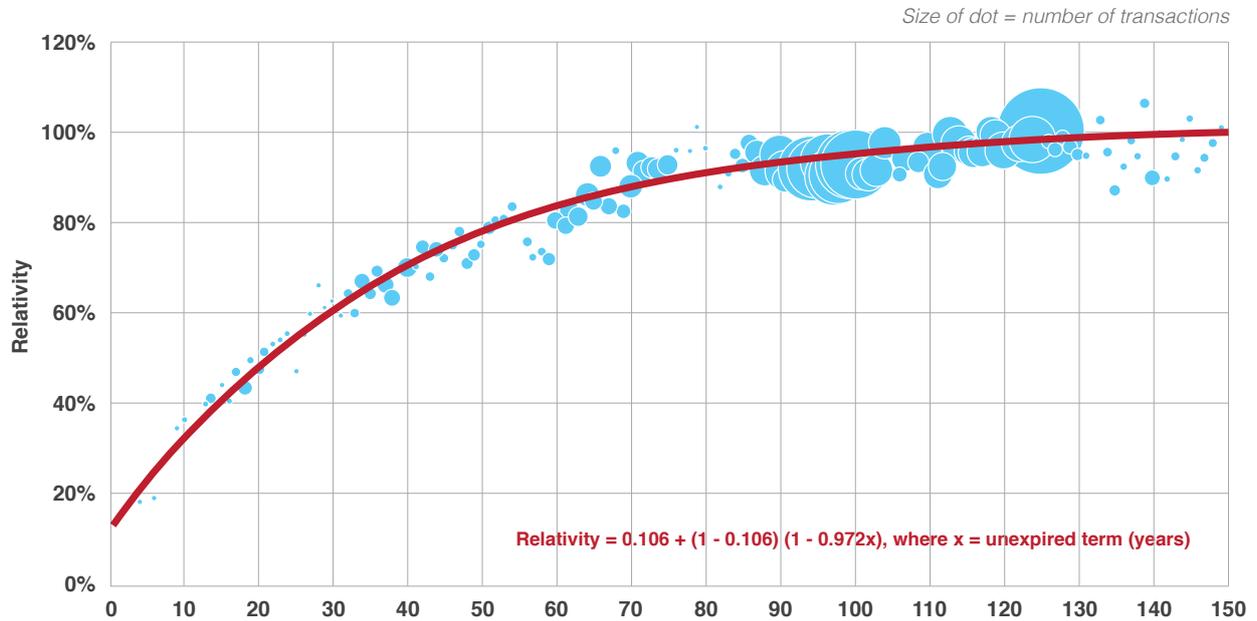
**However, the Upper Tribunal stated the Graph was:**

- “... was the subject of technical criticism”
- “... failed both the Box-Cox Test and the Ramsey Reset Test”.
- “...it is likely to be beneficial if those technical criticisms could be addressed and removed.”

**However, the Spotlight Publication states:**

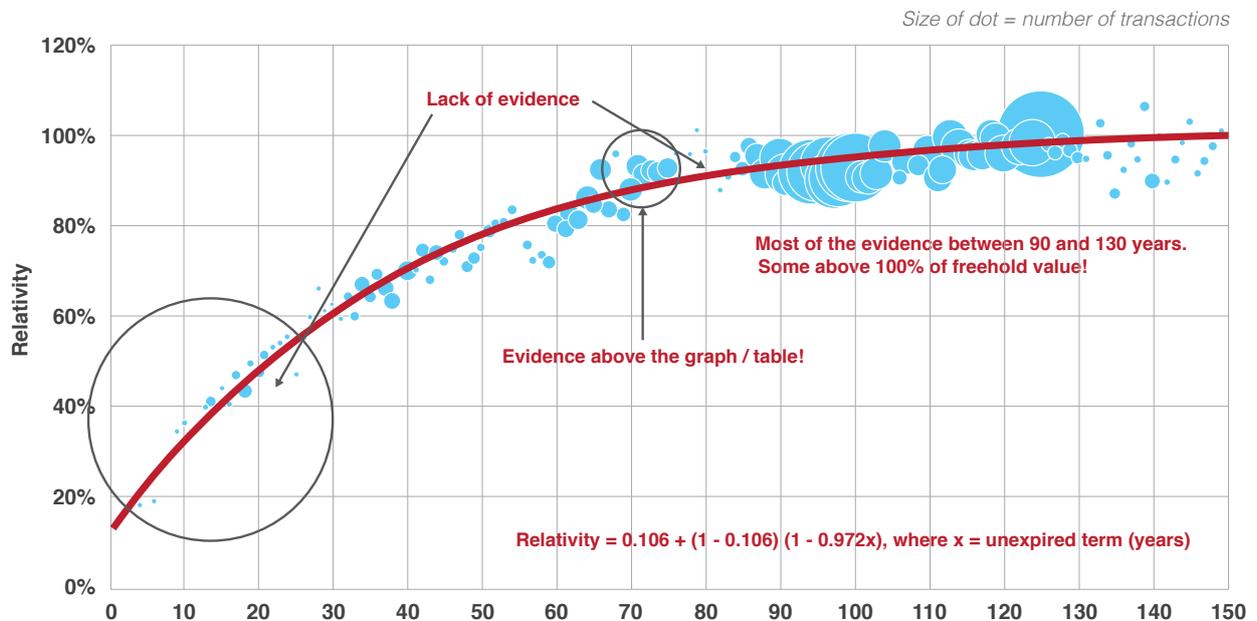
- “... analysis is **unchanged** from that provided in evidence to the Tribunal”

## Savills Enfranchisable Graph 2015



## Questions on the Savills Enfranchisable Graph 2015

Current market relativity for enfranchiseable leases



Source: Savills Research using Lonres (data from January 2010 to June 2015)

**Having reviewed the graph to weigh up whether we should adopt the graph outside Prime Central London, I noticed the following:**

- Apart from the facts mentioned above, the graph is based only transactions within Prime Central London, where the freeholders are notoriously tough negotiators. It also failed both the Box-Cox Test and the Ramsey Reset Test.
- Most of the evidence appears to be for leases between 90 to 130 years (I also note, that bizarrely some long lease prices are above 100% of the freehold value).
- Marriage Value is only payable on leases with 80 years unexpired or less, so all the evidence above this level is of little benefit for establishing relativity for Marriage Value.
- There are some significant gaps in the evidence: between 75 and 85 years, between 50 and 60 and below 35 years.
- A line of “best fit” graph is best used when the evidence is evenly distributed at each datapoint. However, at some lease lengths the evidence is scattered and not even. The graph averages the evidence along the full length of the curve. Thus, the graph does not reflect the evidence at key unexpired terms along the line of the graph.
- At 70 to 80 years all the evidence is above the curve and shows relativity at approximately 95%. However, the curve and therefore the table suggests **87% to 90%**! This results in a significant overpayment of premium payable at these lease lengths. At other lease lengths the curve will result in a significant underpayment of premium. These are likely to effect fewer lease extensions, as the majority of lease extension tend to be between above 70 years.

- The values suggested by the **Savills Graph 2015** are lower than those suggested by the **Gerald Eve Graph 1996**, when the unexpired lease length is above **72 years**. The Upper Tribunal described this as **anomalous**. It would have been expected that the **Savills Enfranchisable Graph** would result in higher values as it has the benefit of the “Act Rights” reflected.
- Should we continue to use this graph when:
  - i. The vast majority of the evidence is for leases above 80 years?
  - ii. There are significant gaps in the data?
  - iii. The line of best fit produces incorrect results particularly where the evidence is scattered?
  - iv. The evidence suggests the graph is wrong at certain points, particularly at 70-80 years?

**General points cautionary note on evidence:**

- There is very little short lease evidence.
- It could be argued that as most flat owners with 2-year ownership qualify for a lease extension, sales of short leasehold flats may indicate a lack of knowledge by the lessee or a distressed sale.
- Analysis of short lease evidence is extremely volatile, as it relies on comparing and adjusting comparables of both long leases and short leases simultaneously. This can often lead to unrealistic relativities, as the short lease comparables are often not adjusted to take account of poor condition, and the long lease comparables are not adjusted to take account of improvements.

## The Law Commission

The Law Commission launched a consultation into leasehold home ownership in September 2018.

The terms of reference were to provide a better deal for leaseholders. They were due to publish their final report on the options to reduce the price of enfranchisement in November 2019, but publication has been delayed due to the General Election.

Whether they opt to recommend abolishment of Marriage Value, set a statutory relativity or just tinker with cost is going to be very interesting.

## Summary

The Upper Tribunal have recently made decisions that will make the cost of most lease extensions much more expensive, particularly outside Prime Central London.

Ironically, at the same time The Law Commission are charged with coming up with proposals to reduce the cost to leaseholders.

In the light of this, perhaps it's time to revisit the RICS Report. I'm reminded of the famous Mark Twain quote "Reports of my Death have been greatly exaggerated"

I would be interested to hear other views on this subject.

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