A question of marriage value

Should valuation of the tenants' interests on a collective enfranchisement take account of the 1993 Act, or assume a 'no Act world'? Natasha Rees considers a Court of Appeal decision on the issue

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The appeal case *McHale v Cadogan* [2010] concerns an important issue relating to the way in which participating tenants' interests should be valued for the purposes of collective enfranchisement. Schedule 6 of the Leasehold Reform Housing and Urban Development Act 1993 contains very detailed provision for calculating the price to be paid by tenants when enfranchising. One key element of the price is the 'marriage value', half of which must be paid by the participating tenants to the landlord.

Marriage value

Marriage value arises because the value of the freeholder's interest in a flat plus the value of the existing lease of the flat is normally worth less than a 999-year lease of the flat. The marriage value is, essentially, the increase in the value of the freehold attributable to the ability of the participating tenants to grant themselves 999-year leases. In order to determine the marriage value, both the freeholder's interest and the tenants' interests need to be valued. For some reason, Schedule 6 only contains special directions about how the freeholder's interest should be valued. There are no directions relating to the valuation of the tenants' interests. There has, therefore, been much debate about how tenants' interests should be valued, and it was this issue that the Court of Appeal had to consider.

The 'no Act world'

One of the directions in Schedule 6 states that the value of the outgoing freeholder's interest is to be calculated on a 'no Act world' basis. This means that the market price must be assessed as if the rights to enfranchisement under the 1993 Act do not exist. The Court of Appeal was asked to decide whether, in working out the marriage value, the existing leases of the participating tenants should also be valued on a 'no Act world' basis. The reason this is significant is because if the valuation is carried out according to this artificial assumption it produces a substantially higher price.

Facts

The appeal concerned a building known as 10 Sloane Gardens, which was situated on the Cadogan Estate and divided into six flats. The first appellant, Mr McHale, was an intermediate landlord under a head lease. The second appellant, 10 Sloane Garden Management Limited was the nominee purchaser in the collective enfranchisement claim, but I will refer to them collectively as 'McHale'.

In the collective claim, the Leasehold Valuation Tribunal had originally determined an enfranchisement price of £770,940. In reaching this figure, they held that the existing leases of the participating tenants' interests should be valued on the 'no Act rights' assumption. McHale applied for leave to appeal to the Lands Tribunal. He was granted leave by the LVT but his appeal was dismissed. He then applied to the Court of Appeal and was granted leave to appeal on two issues.

The first issue concerned the valuation of the caretaker's flat and whether it should be valued on the basis that it is dedicated to housing a caretaker rent-free, and thus is of little value, or whether it should be valued on the basis that the tenants nevertheless

have to pay a service charge to compensate for this loss of rent. If it is valued as a dedicated caretaker's flat, the value of the leasehold interest is lower and the marriage value higher. The Court of Appeal decided this issue first at an earlier hearing and concluded that the head lease should be valued on the basis that Mr McHale, as head lessee, is entitled to be compensated through the service charge for the loss of rent.

The second issue concerned marriage value and whether the tenants' interest should be assessed according to the directions that apply to the valuation of the landlord's interest. Nominee purchaser tenants involved in two other collective claims on the Cadogan Estate, which were appealing this issue in the Landlord's Tribunal, joined this part of the appeal as interveners due to the significant impact it would have on their premium. It is for this reason that this issue was adjourned to a separate hearing.

The statutory framework

The valuation exercise for collective claims is contained in Schedule 6 of the 1993 Act. Paragraph 4(2) provides how the freeholder's share of marriage value should be calculated:

> the marriage value is any increase in the aggregate value of the freehold and any intermediate interest in the specified premises, when regarded as being interests under the control of the participating tenants, as compared with the aggregate value of those interests when held by the persons from whom they are to be so acquired...

Paragraph 4(4)(a) incorporates three specific assumptions to be applied when valuing the freeholder's interest:

- The 'no Act rights' assumption:

> on the assumption that this Chapter and Chapter II confer no right to acquire any interest in the specified premises or to acquire a new lease...

- The 'improvements' disregard:

> on the assumption that any increase in the value of any flat held by a participating tenant which is attributable to an improvement carried out at his own expense by the tenant or by any predecessor is to be disregarded...

- The 'anti-increase' disregard:

> the value of the freeholder's interest in the specified premises shall not be increased by reason of

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1) any transaction which –

   a) Is entered into on or after the date of the passing of this Act (otherwise than in pursuance of a contract entered into before that date), and

   b) Involves the creation or transfer of an interest superior to (whether or not preceding) any interest held by a qualifying tenant of a flat contained in the specified premises; or

2) Any alteration on or after that date of the terms on which any such superior interest is held...

As stated above, the issue in this appeal concerned the 'no Acts right' assumption and whether it should be applied to the tenants' interests when calculating marriage value. It is, however, important to consider all three assumptions because they also appear together in Schedule 13 of the 1993 Act. This schedule contains the valuation exercise that must be followed to calculate the premium payable for an extended lease. Schedule 13 has always contained the trio of assumptions to be applied when valuing the landlord's interest, but it was only after a later amendment to Schedule 13 by the Housing Act 1996 and the insertion of a new paragraph 4B that the 'no Act rights' assumption was applied to the tenants' interests.

Arguments in the appeal

Both counsel in the appeal argued that it was a simple question of statutory construction, although the outcome of their interpretations was completely different. Stephen Jourdan QC, in support of Mr McHale and on behalf of the interveners, submitted that the assumptions contained in Schedule 6 referred only to the valuation of the landlord's interest and therefore did not apply when valuing the tenants' interests. He stated that the valuation should take place on the basis of reality in the absence of contrary indication in the statute. His key argument relied on the amendments that were made to Schedule 13 of the 1993 Act relating to the price payable for an extended lease. As stated above, this schedule originally contained no reference to applying the 'no Act rights' assumption when valuing the tenants' interest, which was added later by the Housing Act 1996. Schedule 6, on the other hand, was not amended and, in the context of the 1993 Act as a whole, this suggested that Schedule 6 should be applied differently. Likewise the Anti-Increase Direction applied to both the landlord's and tenants' interests in Schedule 13, but not to the tenants' interests in Schedule 6.

Since parliament had specifically excluded the tenants' statutory rights from the valuation of the landlord's interest in Schedule 6, in order to produce a consistent valuation, the same exclusion must apply when determining the value of the tenants' interests.

Anthony Radevsky, on behalf of Cadogan, also argued that it was a simple question of statutory interpretation, but he claimed it should be answered by reference to Schedule 6 alone. He referred to the definition of marriage value in s4 and stated that the valuation exercise could only be properly carried out if the 'no Act world' assumption was applied to both the landlord's and the tenants' interests. He stated that there was no direction in the 1993 Act that the existing interests of the tenants should be valued differently. He also supported his argument by reference to 'the Pointe Gourde principle', which is the principle of compulsory purchase valuation that when valuing land taken compulsorily any increase in value due to the scheme itself should be disregarded.

Judgment

Arden LJ, who gave the leading judgment, accepted the arguments put forward on behalf of the landlord and dismissed the appeal. She felt that it was necessary to consider the interpretation of Schedule 6 as it stands rather than in conjunction with Schedule 13. Her reason for this was that the two sets of provisions operated independently and were structured in a different way. She claimed it was, therefore, perfectly possible in such circumstances, and without creating absurdity, for Parliament to use different statutory language in one schedule from that in another. Since parliament had specifically excluded the tenants' statutory rights from the valuation of the landlord's interest in Schedule 6, in order to produce a consistent valuation, the same exclusion must apply when determining the value of the tenants' interests.

Arden LJ also stated that she felt that the Pointe Gourde principle was a logical principle and that her interpretation of Schedule 6 was consistent with this principle. Further, she felt that the presence of artificial assumptions displaced the presumption that the valuation is to be conducted on the basis of reality. Although it was a generous result to the freeholder, she said it was important to bear in mind that the freeholder only received 50% of the marriage value.

Final word?

As a result of this decision tenants will have to pay more for the freehold when they collectively enfranchise. Mr McHale and the interveners have applied to the Supreme Court for permission to appeal the decision. At the time of writing it is not yet known whether leave will be given. In a recent Lands Tribunal appeal, known as *Earl Cadogan v Cadogan Square Properties Limited* [2011], the nominee purchaser asked the Lands Tribunal whether the parties could revisit the premium determined by the tribunal if the Supreme Court overturned the decision of the Court of Appeal. The Lands Tribunal held that it was unable to set a 'provisional' price and that their determination was final. As a result of this, where the McHale decision does have a large impact on the premium payable on a collective claim, tenants may want to consider applying to the LVT for the proceedings to be stayed until the Supreme Court have reached a decision. ■

Earl Cadogan v Cadogan Square Properties Limited
[2011] UKUT 68 (LC)
McHale v Cadogan
[2010] EWCA Civ 14