Spotlight
Leasehold Enfranchisement
Analysis of Relativity
May 2016

MODERN RELATIVITY

Launching the Savills 2015 Enfranchiseable Graph of Relativity

■ A recent decision from the Upper Tribunal will result in a modernised approach to calculating relativity in leasehold enfranchisement valuations.

■ Evidence of the market at the valuation date is paramount. Outdated graphs of relativity are unreliable and should not be used.

■ Market and economic changes mean relativity has shifted downwards over time, as discount rates have fallen.

■ Savills 2015 enfranchiseable graph, which was submitted in evidence to the Upper Tribunal, shows real world relativity in the current market and is based on objective analysis of over 5,000 transactions of leasehold flat sales.

■ The statutory "no Act world" assumption refers to the subject lease only. All other leases in the market at the valuation date have the right to extend or buy the freehold. The effect is to reduce the rights a leaseholder possesses in

holding the subject lease compared to leases in the market.

■ A discount needs to be made from the Savills 2015 enfranchiseable graph to calculate relativity for the purpose of carrying out a leasehold enfranchisement valuation. This discount declines with increasing unexpired lease term and we have collected a range of reference points.

■ Relativity tables are provided for the new enfranchiseable graph and a new unenfranchiseable graph.

HOW TO CALCULATE RELATIVITY?

The relativity challenges

For many years, relativity had been assessed with reference to scarce market evidence from unenfranchiseable lease sales and the graphs of relativity produced by various surveyors' firms. However, the evidence behind these curves varies in quality and in many cases has been lost, preventing them being tested by parties to current disputes over the appropriate premium to be paid.

In June 2014, a challenge to this approach was heard in the Upper Tribunal, advocating the use of an hedonic regression analysis of transactions from 1987-1991, before the 1993 Act which extended enfranchisement rights to all houses and brought in the right for leaseholders of flats to extend their leases or buy the freehold of the building.

This challenge failed, largely because it was felt that analysis of an historic market was not relevant to assessing relativity in the current market. Relativity is effectively a function of discount rates. The lower the discount rate, the lower relativity becomes. It is clear that we should expect relativity to have changed over the last 20 years, with current relativity being substantially lower than it was in the 1990s.

A further challenge was mounted in January 2016, again promoting use of the hedonic regression analysis of pre-1993 Act transactions. This time the decision was clearer, comprehensively rejecting the analysis of pre-1993 Act transactions and finding it probable that "economic and market changes since 1987-1991 have indeed lowered relativities."

The Tribunal considered detailed evidence on many of the graphs of relativity produced by surveyors' firms, but gained little or no assistance from most in arriving at its decision. One exception was the Gerald Eve graph, which was found to have become "the industry standard", but evidence was heard that suggested it "may indeed now overstate relativities for leases without rights under the 1993 Act" and it was regarded as secondary to market evidence.

Modernising relativity

Evidence was also heard regarding the new Savills 2015 enfranchiseable graph. Although it was found that this graph is "subject to some possible technical criticisms", the Tribunal commended it as "a significant improvement on the Savills 2002 enfranchiseable graph, being based upon recent market transactions which have been objectively analysed". The analysis presented here is unchanged from that provided in evidence to the Tribunal.

Using data from Lonres, we carried out an hedonic regression analysis of the current market using data from January 2010 to June 2015. Hedonic regression is an approach widely used in housing market analysis, including as the basis for the Nationwide and Halifax house price indices.

The approach relies on the assumption that the total value of a property is made up of the cumulative effect of its characteristics, for example number of bedrooms, size, parking, garden, location, etc., and allocates a proportion of value to each of these. For leasehold property, the length of the unexpired term is clearly a key characteristic in determining

ENFRANCHISEMENT BASICS

THE LEGAL CONTEXT

Leasehold enfranchisement rights were first introduced in the 1960s and have undergone a number of changes since, culminating in the Commonhold and Leasehold Reform Act of 2002. The result of the legislation has been to give leaseholders the right to purchase the freehold of a house, the freehold of a block of flats or to extend the lease of a flat.

In order to purchase the freehold or extend a lease, the tenant must pay the landlord an appropriate premium to reflect the transfer of rights and this is done through a statutory formula, as follows:

The reduction in the value of the landlord's interest
+
Half of the marriage value (only if the existing lease has less than 80 years to run)
+
Compensation to the landlord for severance or other losses

Calculation of the marriage value involves assessing the value of the lease at its current length relative to the value of the same property assuming it was held freehold. This percentage is commonly referred to as relativity.

THE STATUTORY ASSUMPTION

The valuation is subject to the hypothetical assumption that the lease being valued does not have the right conferred by statute, i.e. to extend the lease or buy the freehold. All other leases in the market at the point of valuation do have these rights.

Whilst the valuation is made with reference to market evidence and at the date on which the statutory notice was served, there is no market evidence available that exactly replicates the statutory assumption because, with rare exceptions, the situation has never existed.

This assumption is often referred to as a 'no-Act world', but it is only a 'no-Act world' for the subject lease and not for any of the other leases in the market.

value. Our model produces a range of coefficients to describe the contribution to value made by each characteristic. These all make intuitive sense, building our confidence in the model.

Our most robust model analyses 5,904 sales of leasehold flats and provides the point estimates of relativity for each lease length shown in Graph 1. The size of the point indicates the number of data points at each lease length. We have then fitted a curve to the point estimates of relativity. The equation for this curve is shown on the graph.

The analysis provides a starting point for the assessment of relativity; it gives an estimate of relativity for a lease with Act rights in the current market. A deduction from this level would need to be made in a valuation of a lease on the hypothetical assumption that the lease being valued does not have the rights conferred by statute, i.e. to extend the lease or join in a collective purchase of the freehold.
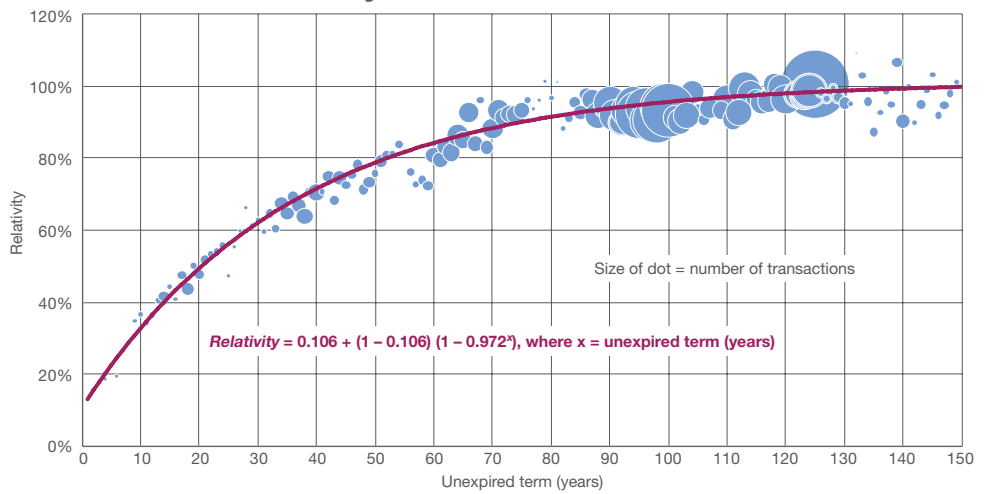
Discount

The effect of the statutory assumption is to reduce the rights a leaseholder possesses in holding the subject lease compared to leases in the market. The current market curve we have derived therefore marks the maximum relativity for leasehold reform valuations, with adjustment required to take account of the statutory assumption, reducing relativity below this market level.

The evidence available to assess the discount required from the real world curve shown in Graph 1 is scarce. We have compiled a range of reference points for the discount required from the current market relativity to calculate relativity under the statutory assumption (Graph 2).

Based on these reference points, Graph 2 shows estimates for the deductions that need to be made to convert from an enfranchiseable to an unenfranchiseable relativity for a full range of unexpired terms.

As best we can, we have fitted a curve through these reference points from which the discount from enfranchiseable relativity can be estimated for every lease length. The resulting unenfranchiseable curve is shown alongside the enfranchiseable curve in Graph 3. ◼

GRAPH 1

Current market relativity for enfranchiseable leases

Size of dot = number of transactions

$Relativity = 0.106 + (1 − 0.106)(1 − 0.972^x)$, where x = unexpired term (years)

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

GRAPH 2

Reference points for the discount required from enfranchiseable relativity to unenfranchiseable relativity

Cadogan v Cadogan Square

Flat 3, 36 Elm Park Road

82 Portland Place

Chelsea Properties v Cadogan

18 Gerald Road

Eyre Estate v Saphir
Flat 11, 26-28 Elm Park Road

58 Hamilton Terrace

Flat 5, 17 Cranley Gardens

Nailrile v Cadogan
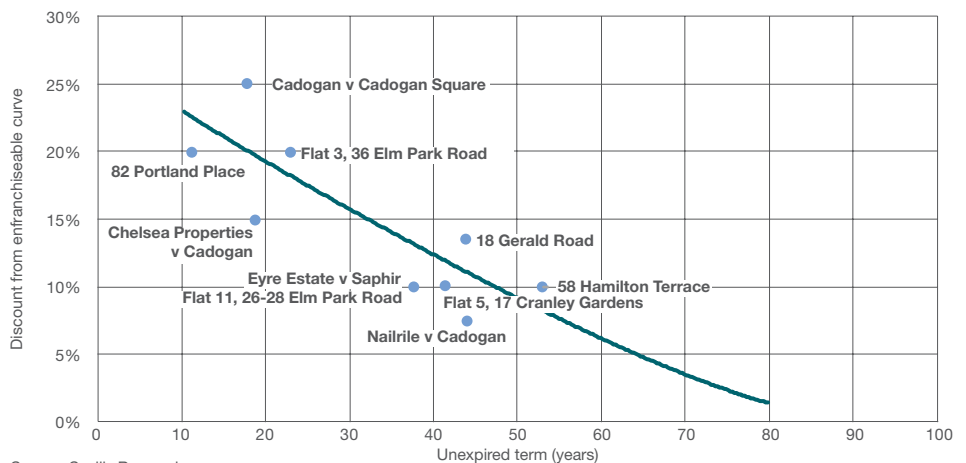
Source: Savills Research

GRAPH 3

Relativity for enfranchiseable and unenfranchiseable leases

Savills Enfranchiseable

Savills Unenfranchiseable
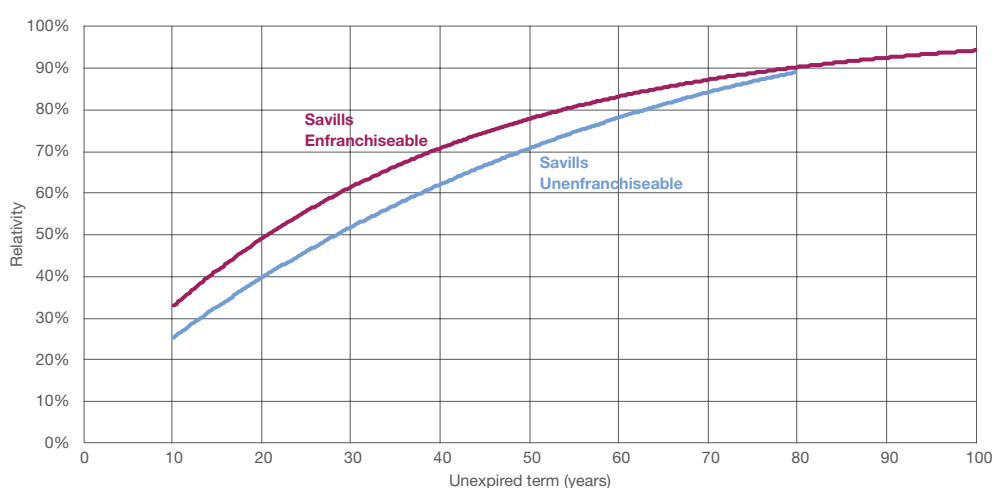
Source: Savills Research using Lonres data

SAVILLS RELATIVITY GRAPHS

Unexpired term (years)	Enfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity
0.25	11.2%	10.25	32.9%	25.0%	20.25	49.3%	39.5%	30.25	61.7%	52.0%	40.25	71.1%	62.3%
0.50	11.8%	10.50	33.4%	25.4%	20.50	49.7%	39.8%	30.50	62.0%	52.3%	40.50	71.3%	62.6%
0.75	12.5%	10.75	33.9%	25.8%	20.75	50.0%	40.2%	30.75	62.2%	52.6%	40.75	71.5%	62.8%
1.00	13.1%	11.00	34.3%	26.1%	21.00	50.4%	40.5%	31.00	62.5%	52.9%	41.00	71.7%	63.1%
1.25	13.7%	11.25	34.8%	26.5%	21.25	50.7%	40.8%	31.25	62.8%	53.2%	41.25	71.9%	63.3%
1.50	14.3%	11.50	35.2%	26.9%	21.50	51.1%	41.2%	31.50	63.0%	53.4%	41.50	72.1%	63.5%
1.75	14.9%	11.75	35.7%	27.3%	21.75	51.4%	41.5%	31.75	63.3%	53.7%	41.75	72.3%	63.7%
2.00	15.5%	12.00	36.1%	27.7%	22.00	51.7%	41.8%	32.00	63.5%	54.0%	42.00	72.4%	64.0%
2.25	16.1%	12.25	36.6%	28.1%	22.25	52.1%	42.1%	32.25	63.8%	54.2%	42.25	72.6%	64.2%
2.50	16.6%	12.50	37.0%	28.5%	22.50	52.4%	42.5%	32.50	64.0%	54.5%	42.50	72.8%	64.4%
2.75	17.2%	12.75	37.5%	28.8%	22.75	52.7%	42.8%	32.75	64.3%	54.8%	42.75	73.0%	64.7%
3.00	17.8%	13.00	37.9%	29.2%	23.00	53.1%	43.1%	33.00	64.5%	55.1%	43.00	73.2%	64.9%
3.25	18.4%	13.25	38.3%	29.6%	23.25	53.4%	43.4%	33.25	64.8%	55.3%	43.25	73.4%	65.1%
3.50	18.9%	13.50	38.8%	30.0%	23.50	53.7%	43.7%	33.50	65.0%	55.6%	43.50	73.6%	65.3%
3.75	19.5%	13.75	39.2%	30.3%	23.75	54.0%	44.0%	33.75	65.3%	55.8%	43.75	73.8%	65.6%
4.00	20.1%	14.00	39.6%	30.7%	24.00	54.4%	44.4%	34.00	65.5%	56.1%	44.00	73.9%	65.8%
4.25	20.6%	14.25	40.0%	31.1%	24.25	54.7%	44.7%	34.25	65.8%	56.4%	44.25	74.1%	66.0%
4.50	21.2%	14.50	40.4%	31.5%	24.50	55.0%	45.0%	34.50	66.0%	56.6%	44.50	74.3%	66.2%
4.75	21.7%	14.75	40.9%	31.8%	24.75	55.3%	45.3%	34.75	66.2%	56.9%	44.75	74.5%	66.5%
5.00	22.3%	15.00	41.3%	32.2%	25.00	55.6%	45.6%	35.00	66.5%	57.2%	45.00	74.7%	66.7%
5.25	22.8%	15.25	41.7%	32.6%	25.25	55.9%	45.9%	35.25	66.7%	57.4%	45.25	74.8%	66.9%
5.50	23.4%	15.50	42.1%	32.9%	25.50	56.2%	46.2%	35.50	66.9%	57.7%	45.50	75.0%	67.1%
5.75	23.9%	15.75	42.5%	33.3%	25.75	56.6%	46.5%	35.75	67.2%	57.9%	45.75	75.2%	67.3%
6.00	24.4%	16.00	42.9%	33.6%	26.00	56.9%	46.8%	36.00	67.4%	58.2%	46.00	75.4%	67.5%
6.25	25.0%	16.25	43.3%	34.0%	26.25	57.2%	47.1%	36.25	67.6%	58.4%	46.25	75.5%	67.8%
6.50	25.5%	16.50	43.7%	34.4%	26.50	57.5%	47.4%	36.50	67.9%	58.7%	46.50	75.7%	68.0%
6.75	26.0%	16.75	44.1%	34.7%	26.75	57.8%	47.7%	36.75	68.1%	58.9%	46.75	75.9%	68.2%
7.00	26.5%	17.00	44.5%	35.1%	27.00	58.0%	48.0%	37.00	68.3%	59.2%	47.00	76.0%	68.4%
7.25	27.0%	17.25	44.9%	35.4%	27.25	58.3%	48.3%	37.25	68.5%	59.4%	47.25	76.2%	68.6%
7.50	27.5%	17.50	45.3%	35.8%	27.50	58.6%	48.6%	37.50	68.7%	59.7%	47.50	76.4%	68.8%
7.75	28.0%	17.75	45.6%	36.1%	27.75	58.9%	48.9%	37.75	69.0%	59.9%	47.75	76.5%	69.0%
8.00	28.6%	18.00	46.0%	36.5%	28.00	59.2%	49.2%	38.00	69.2%	60.2%	48.00	76.7%	69.2%
8.25	29.1%	18.25	46.4%	36.8%	28.25	59.5%	49.5%	38.25	69.4%	60.4%	48.25	76.9%	69.4%
8.50	29.5%	18.50	46.8%	37.1%	28.50	59.8%	49.8%	38.50	69.6%	60.7%	48.50	77.0%	69.6%
8.75	30.0%	18.75	47.1%	37.5%	28.75	60.1%	50.1%	38.75	69.8%	60.9%	48.75	77.2%	69.9%
9.00	30.5%	19.00	47.5%	37.8%	29.00	60.3%	50.3%	39.00	70.0%	61.1%	49.00	77.4%	70.1%
9.25	31.0%	19.25	47.9%	38.2%	29.25	60.6%	50.6%	39.25	70.2%	61.4%	49.25	77.5%	70.3%
9.50	31.5%	19.50	48.2%	38.5%	29.50	60.9%	50.9%	39.50	70.4%	61.6%	49.50	77.7%	70.5%
9.75	32.0%	19.75	48.6%	38.8%	29.75	61.2%	51.2%	39.75	70.7%	61.9%	49.75	77.8%	70.7%
10.00	32.4%	20.00	49.0%	39.2%	30.00	61.4%	51.5%	40.00	70.9%	62.1%	50.00	78.0%	70.9%

Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unenfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity	Unexpired term (years)	Enfranchiseable relativity
50.25	78.1%	71.1%	60.25	83.5%	78.4%	70.25	87.5%	84.6%	80.25	90.6%	90.25	92.9%
50.50	78.3%	71.3%	60.50	83.6%	78.6%	70.50	87.6%	84.7%	80.50	90.6%	90.50	92.9%
50.75	78.4%	71.5%	60.75	83.7%	78.8%	70.75	87.7%	84.9%	80.75	90.7%	90.75	93.0%
51.00	78.6%	71.7%	61.00	83.8%	79.0%	71.00	87.8%	85.0%	81.00	90.8%	91.00	93.0%
51.25	78.7%	71.9%	61.25	83.9%	79.1%	71.25	87.9%	85.1%	81.25	90.8%	91.25	93.1%
51.50	78.9%	72.1%	61.50	84.0%	79.3%	71.50	87.9%	85.3%	81.50	90.9%	91.50	93.1%
51.75	79.0%	72.3%	61.75	84.2%	79.4%	71.75	88.0%	85.4%	81.75	91.0%	91.75	93.2%
52.00	79.2%	72.5%	62.00	84.3%	79.6%	72.00	88.1%	85.5%	82.00	91.0%	92.00	93.2%
52.25	79.3%	72.7%	62.25	84.4%	79.8%	72.25	88.2%	85.7%	82.25	91.1%	92.25	93.3%
52.50	79.5%	72.8%	62.50	84.5%	79.9%	72.50	88.3%	85.8%	82.50	91.1%	92.50	93.3%
52.75	79.6%	73.0%	62.75	84.6%	80.1%	72.75	88.4%	85.9%	82.75	91.2%	92.75	93.4%
53.00	79.8%	73.2%	63.00	84.7%	80.3%	73.00	88.4%	86.1%	83.00	91.3%	93.00	93.4%
53.25	79.9%	73.4%	63.25	84.8%	80.4%	73.25	88.5%	86.2%	83.25	91.3%	93.25	93.4%
53.50	80.0%	73.6%	63.50	84.9%	80.6%	73.50	88.6%	86.3%	83.50	91.4%	93.50	93.5%
53.75	80.2%	73.8%	63.75	85.0%	80.7%	73.75	88.7%	86.4%	83.75	91.4%	93.75	93.5%
54.00	80.3%	74.0%	64.00	85.1%	80.9%	74.00	88.8%	86.6%	84.00	91.5%	94.00	93.6%
54.25	80.5%	74.2%	64.25	85.2%	81.0%	74.25	88.8%	86.7%	84.25	91.6%	94.25	93.6%
54.50	80.6%	74.4%	64.50	85.3%	81.2%	74.50	88.9%	86.8%	84.50	91.6%	94.50	93.7%
54.75	80.7%	74.5%	64.75	85.4%	81.4%	74.75	89.0%	86.9%	84.75	91.7%	94.75	93.7%
55.00	80.9%	74.7%	65.00	85.5%	81.5%	75.00	89.1%	87.1%	85.00	91.7%	95.00	93.8%
55.25	81.0%	74.9%	65.25	85.6%	81.7%	75.25	89.1%	87.2%	85.25	91.8%	95.25	93.8%
55.50	81.1%	75.1%	65.50	85.7%	81.8%	75.50	89.2%	87.3%	85.50	91.9%	95.50	93.8%
55.75	81.3%	75.3%	65.75	85.8%	82.0%	75.75	89.3%	87.4%	85.75	91.9%	95.75	93.9%
56.00	81.4%	75.5%	66.00	85.9%	82.1%	76.00	89.4%	87.6%	86.00	92.0%	96.00	93.9%
56.25	81.5%	75.7%	66.25	86.0%	82.3%	76.25	89.4%	87.7%	86.25	92.0%	96.25	94.0%
56.50	81.6%	75.8%	66.50	86.1%	82.4%	76.50	89.5%	87.8%	86.50	92.1%	96.50	94.0%
56.75	81.8%	76.0%	66.75	86.2%	82.6%	76.75	89.6%	87.9%	86.75	92.1%	96.75	94.1%
57.00	81.9%	76.2%	67.00	86.3%	82.7%	77.00	89.7%	88.0%	87.00	92.2%	97.00	94.1%
57.25	82.0%	76.4%	67.25	86.4%	82.9%	77.25	89.7%	88.1%	87.25	92.2%	97.25	94.1%
57.50	82.2%	76.5%	67.50	86.5%	83.0%	77.50	89.8%	88.3%	87.50	92.3%	97.50	94.2%
57.75	82.3%	76.7%	67.75	86.6%	83.2%	77.75	89.9%	88.4%	87.75	92.4%	97.75	94.2%
58.00	82.4%	76.9%	68.00	86.7%	83.3%	78.00	90.0%	88.5%	88.00	92.4%	98.00	94.3%
58.25	82.5%	77.1%	68.25	86.8%	83.5%	78.25	90.0%	88.6%	88.25	92.5%	98.25	94.3%
58.50	82.6%	77.2%	68.50	86.9%	83.6%	78.50	90.1%	88.7%	88.50	92.5%	98.50	94.3%
58.75	82.8%	77.4%	68.75	87.0%	83.7%	78.75	90.2%	88.8%	88.75	92.6%	98.75	94.4%
59.00	82.9%	77.6%	69.00	87.1%	83.9%	79.00	90.2%	88.9%	89.00	92.6%	99.00	94.4%
59.25	83.0%	77.8%	69.25	87.2%	84.0%	79.25	90.3%	89.0%	89.25	92.7%	99.25	94.5%
59.50	83.1%	77.9%	69.50	87.2%	84.2%	79.50	90.4%	89.2%	89.50	92.7%	99.50	94.5%
59.75	83.2%	78.1%	69.75	87.3%	84.3%	79.75	90.4%	89.3%	89.75	92.8%	99.75	94.5%
60.00	83.4%	78.3%	70.00	87.4%	84.4%	80.00	90.5%	89.4%	90.00	92.8%	100.00	94.6%

Please contact us for further information

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Notes

Quotations in the text are taken from the decision of a case heard in the Upper Tribunal between The Trustees of the Sloane Stanley Estate and Mundy, between The Trustees of the Sloane Stanley Estate and Lagesse, and between Aaron and Wellcome Trust Limited, [2016] UKUT 0223 (LC), case numbers LRA 20, 21 and 35/2015

Savills Research

The Savills research team is unique in providing advice and analysis to clients across all commercial, residential and agricultural sectors of the property market. The established team has a strong reputation for producing accurate, well-informed and, above all else, independent analysis and commentary. External clients include developers, landlords, investors and occupiers.

Savills plc

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