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Material Enhancement – One practitioner's view

Background and the Law

The issue of material enhancement arises in connection with restrictive covenants which a landlord may wish to impose and/or include within the terms of the transfer of the freehold for houses, under the Leasehold Reform 1967 Act and for flats under the Leasehold Reform Housing and Urban Development Act 1993.

The basic rule is that a landlord cannot require the continuance of any of the covenants imposed by the tenants lease, except in strictly limited circumstances set out in section 10 (4) and (5) of the 1967 Act. In order to come within Section 10 (4) (b) or (c) the landlord must show:

(i) That the restriction must be capable of benefitting other property owned by the landlord and must be such as to materially enhance the value of the landlords other property.
(ii) That the restriction must be in the existing lease (subsection (b)) or will not interfere with the reasonable enjoyment of the house and premises as they have been enjoyed during the tenancy (subsection (c)) and
(iii) In either case by Section 10 (5) of the Act unreasonable restrictions are not allowed where there have been changes since the date the tenancy commenced and where the tenancy is one of a number of tenancies of neighbouring houses in view of the interests of those affected in respect of other houses.

Restrictive covenants can also be imposed through Schemes of Management which have been granted under the 1967 Act.

Valuation Impact

The primary valuation issues which can arise in relation to material enhancement relate to the use and alterations of premises. This includes whether a property can be used for alternative residential uses such as a house or flats or specific alternative uses such as residential, office, medical etc.

In most cases, a landlord is seeking to restrict the use of the premises, whereas a lessee is seeking to obtain as wide a user clause as possible.

I was involved in the leading case on this issue which is Moreau v The Howard de Walden Estate (LRA/2/2002) and related to a property at 27 Weymouth Street London, W1. This was a Lands Tribunal decision where initially permission to appeal was refused but subsequently, the appeal was permitted, but the case did not reach the Court of Appeal because the claimant was able to compromise a settlement with the freeholders. This case was heard in 2002 and to my knowledge there have been no further cases before the Lands Tribunal on the issue on material enhancement, although there are a number of cases pending.

In this case, it was held that the disputed covenants materially enhanced the value of other property of the respondents and what amounted to material enhancement was a matter of general impression. The Lands Tribunal member Mr Clark took the view that material enhancement can only be considered in general terms. His view was that we are not concerned with diminution in value but material enhancement in value as a consequence of the restrictions. As a result, this case is beneficial to landlords who have been able to maintain specific uses for properties to protect their Estates!
Had the case gone to the Court of Appeal, Leading Counsel advised that there was a good chance of success for the following reasons:

1. The Lands Tribunal Member made no findings of material enhancement in value, in the meaning of Section 10 (4) (c) of the 1967 Act because he asked the wrong question.

2. The Lands Tribunal Member took the material enhancement test to be satisfied, if it could be shown that any diminution in value could be demonstrated to other property of the Respondent by the absence of the disputed covenants.

3. The Lands Tribunal Member also made no comparison in dealing with the Alterations clause and User clause as between what the Respondent wanted and what the Appellant was willing to offer.

4. By approaching the test of material enhancement in value in this way, the Lands Tribunal Member opened the way to accepting the vague and impressionistic evidence in diminution in value called by the Respondents in this case and side stepped the need to deal with the respondent valuers concession with a slight diminution in value and avoided having to deal with the fact that the Respondents had made the wrong comparison and evidence.

The Relevant Provisions of Section 10 of the 1967 Act are intended to set the prescribed limits for landlords and, in particular, large Estate owners to interfere with the use to be made of properties acquired by tenants under the Act. To date, these provisions have never been scrutinised by courts and the old erroneous test which emerges from the decisions of the Lands Tribunal in Peck (1970) and Le Mesurier (1972) is routinely used by the large estate landlords to justify the imposition of covenants where no sensible person could think that their absence would have any material effect on any other property.

The matter was considered by the LVT last year in the case of two houses in Grove Road, Bournemouth (CH1/00HN/OLE/2008/0001/and 0002) but it is not known if an appeal was made.

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Some Current Cases

- 87 Hamilton Terrace, NW8, is a current case which has been to the leasehold valuation tribunal and is now on appeal to the Upper Tribunal. This case is expected to be heard later this year or early next year.

- There are two other cases in Cadogan Square - 39 Cadogan Square where the issue arose and a LVT decision is awaited. The issue has also arisen in 13 Cadogan Square where an LVT date is awaited.

- There are also a number of potential cases on the Howard de Walden Estate relating to mixed use medical / residential properties which have yet to be heard by the LVT.

- Although the issue of material enhancement is perhaps a rather remote topic in relation to enfranchisement as a whole, it is felt that perhaps the bar was set too low in the decision in Moreau and should at least be tested in the Court of Appeal. It is hoped that one of the current cases will establish the position once and for all.