



Legal update — May 2017

Real estate litigation

Unfair ground rents and leasehold houses - What's the issue?

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Should it be buyer beware or are they simply a bad idea for all?

What is a ground rent?

Ground rents are generally seen to be a way for the land owner to receive some form of rent for the value of the land on which a property is built, as opposed to rent on the property itself. In the main these rents are minimal sums, either a peppercorn or normally tens or sometimes a few hundred pounds annually and are often reviewed a few times during a lease term, typically every 21 or 33 years.

Ground rent markets

However, the market in ground rents has thrived in recent years with companies set up solely for this purpose, probably due to many seeing it as a good way to get higher returns on investment in what seems to be an era of perpetual low interest rates.

In addition, depending on the interest owned and the length of leases, potential lease extensions and even collective enfranchisements, can generate some significant income. Calculations of the sums payable for lease extensions and enfranchisement are based in part on the levels of ground rent in the leases, which has to be bought out.

Changes in Developers practices

Similarly, in recent years we have seen changes in the way developers have sold their properties, resulting recently with some selling leasehold houses, on estates where there does not appear to be a justifiable estate management reason. This can be seen as a way of benefitting from granting leases, retaining a ground rent and retaining the opportunity to sell the ground rents and freeholds to a third party. Along with this there has been a significant change in the ground rent clauses inserted in these new builds, both houses and flats. This has created increasing levels of long term returns for ground rent companies and increased income for developers who then move on to the next estate leaving problems for those individuals buying. However, it now looks increasingly like this may not have been such a great idea after all.

As with every business, saleability and marketability has to be carefully balanced with profitability on each new development. However, when selling a flat or a house, while it is the look of the property and the amenities on offer that a buyer can see and feel and fall in love with, there remains a lack of understanding of the terms of the lease that is the actual interest they are acquiring.



Source: Shutterstock

What is the ground rent trap?

We have seen that the fact that the lease is "king" and the importance of the obligations in the lease is often not impressed clearly enough on buyers. Leases can be complicated legal documents and buyers of them need to be properly advised and need to understand what their obligations under the lease will be, not just for the immediate short term position but also going forward where the effect on future saleability needs to be considered. Some of these rent reviews include doubling rents every 5 or 10 years or rents linked to indices increasing every 10 years to levels in the thousands or tens of thousands and in some cases, where there are very long leases being granted, into the millions resulting in some leaseholders being trapped in their properties and unable to sell.

What is the market doing about it?

Since the end of 2016, some of the press has picked up on numerous stories of individuals caught in this position, leading not only to raising awareness in print but extending to comment and discussion by MPs in Parliament. We are now seeing some in the market place, notably Taylor Wimpey, Nationwide and

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Yorkshire Building Society, understanding this as an issue that needs to be dealt with.

Taylor Wimpey have now put aside £130 million pounds to compensate buyers caught in a ground rent trap and are offering a Ground Rent Review Assistance Scheme for those that qualify whereby they will enter into deeds of variation to change these onerous ground rents or negotiate with a third party purchaser of the ground rents for them to do so.

Nationwide have said that they will no longer lend to any new build houses or flats where the ground rent is more than 0.1% of the value of the property or where a lease length is less than 125 years for flats or 250 years for houses. Yorkshire Building Society has also changed its CML requirements and will not lend on open ended ground rents nor those capable of being increased by an unspecified amount, they must be capped. This includes those where increases are linked to RPI. They will also not lend where there is a rent review in the first 21 years.

We are closely following the situation to see whether other lenders follow suit and whether any other developers take Taylor Wimpey's lead to right this issue.

Why are the lenders and leaseholders so concerned and should leaseholders be worried that they may in fact own Assured Tenancies and not long leases?

Obviously the effect these onerous ground rents are having on saleability and therefore value of the property is of huge importance to both lenders and leaseholders.

However, there is also another risk to the leaseholders and the lenders. If the lease can be considered to be an assured tenancy because the annual rents are between £250 and £100,000 out of London or £1,000 and £100,000 in London then the rules relating to assured shorthold tenancies would apply. This would include the ability for the landlord to bring a claim for rent arrears under ground 8 of section 8 of the Housing Act 1988. If a landlord can show that the arrears are at a certain level, the court is required to grant possession of the property to the landlord as this is a mandatory ground. Where rent is payable yearly, the landlord need only prove that at least 3 months' rent is more than 3 months in arrears. While a lender is likely to ensure that this does not happen, nevertheless, this risk makes such properties more difficult to find lending available.

Is there anything leaseholder's can do if they have already bought these properties?

In light of Taylor Wimpey's recent announcements and proposals to deal with the problem on sites they have developed, it is hoped that others will follow suit. However, it may not always be in the hands of the

developers and indeed some ground rents may not be considered so onerous to have a big effect on marketability. In those cases the developers may not feel the pressure to do anything about them.

If the developers can't or won't do anything, the leaseholder does have some rights they may want to consider.

For flat owners, statutory claims to either extend their leases or (collectively with their neighbours) to acquire their freehold, will either reduce their ground rent to a peppercorn in the case of lease extensions or will give them the ability to do so if they acquire the freehold.

For house owner, statutory claims to acquire the freehold will also extinguish of the requirement to pay a ground rent.

However, in both cases, premiums will be payable to the freeholder and any intermediate landlord and the high ground rents will affect the sums payable. However, for leaseholders in this position, this may be the most cost effective way of making the property marketable.

One final word of warning – onerous ground rents in some voluntary lease extensions

Just one word of added warning on lease extensions being granted outside of the legislation, as in these cases, it is open to landlords and leaseholders to reach agreement on any terms they wish. This has, on occasion, also led to another circumstance where leaseholders have ended up with onerous ground rents in return, usually, for lower premiums. This may well be a false economy and the ongoing effect should be carefully considered as it can create an unmarketable and unmortgageable lease.

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