

Escalating Ground Rents Toolkit for Licensed Conveyancers

Escalating Ground rents have been in the news recently, with many lenders refusing to lend on new-builds that have ground rents that double or increase dramatically over the period of the lease. The SLC is issuing this special bulletin to ensure its members are aware of the issue and can deal with it appropriately. Clients, lenders and valuers must all be involved in assessing whether this is an issue on all transactions, not just new-builds. This toolkit contains the CML release, a suggested Client Guide, and an Excel ground rent estimator. The position will no doubt evolve over the coming months, but this guide also contains some suggested ways of dealing with the issue.

Four Ground Rent Traps

Clients need to be made aware of the consequences of taking a lease with a potentially high ground rent set out in this bulletin, and be advised to get their valuers advice,

Some house-builders reserve a significant ground rent, that could increase to more than £250 (or £1,000 in Greater London) on a future review of the ground rent. Sometimes the ground rent doubles every 10 or 20 years, or will increase by a stated percentage. The issues mentioned here have been known for over a decade, but for some reason they have only recently become generally appreciated as being a problem.

Lenders have focussed on new-builds at the moment, but the problems also apply to any existing leases.

1. Mandatory possession for rent arrears

In general terms, for leases granted after 1/4/90, if the rent exceeds these amounts at any time during the lease, then the tenancy becomes an Assured Tenancy under s.1 Housing Act 1988 if the property is the owner's 'only or principal home' - even though it is a long lease rather than a short term tenancy. This will not apply if the owner owns the property as a 'buy-to-let'. The position for pre-90 leases is more complex. The risk is that if for any reason the ground rent is not paid, the landlord could seek a mandatory possession order and the court would have to order possession, with no possibility of relief for the owner or the lender. The leaseholder would lose the property and the lender would lose its security.

2. Unaffordable ground rents

Another risk is that the rent will become absurdly high. See the example opposite - a ground rent of £250 that doubles every 10 years will reach £1M in 120 years. In contrast, an increase at 3% a year would only increase to £8,600 over that time. The Excel spreadsheet will help you show clients the effect of doubling when contrasted with the current rate of inflation of 3%.

3. Higher price for enfranchisement or lease extensions

Many owners who want to extend their leases will find that a current or possible future high ground rent will significantly increase the cost of buying a lease extension, or buying the freehold as appropriate.

4. Unsaleable leasehold properties

The combined effect of all, or any, of the previous traps may be that the property becomes worth significantly less in the market. Worse still it could become unsaleable at any price, even to cash buyers who do not require mortgage finance.

Year of Term	Year	Ground Rent	Increase at 3% RPI
0	2017	£250	£250
10	2027	£500	£336
20	2037	£1,000	£452
30	2047	£2,000	£607
40	2057	£4,000	£816
50	2067	£8,000	£1,096
60	2077	£16,000	£1,473
70	2087	£32,000	£1,979
80	2097	£64,000	£2,660
90	2107	£128,000	£3,575
100	2117	£256,000	£4,805
110	2127	£512,000	£6,457
120	2137	£1,024,000	£8,678



Action points for conveyancers

Although currently the focus is on new-build properties it is suggested that these points should be considered on any purchase of an existing lease. If acting on the sale of a flat with escalating ground rents, it would also be prudent to warn the client of any potential problems. It will often be better to renegotiate the lease terms, or claim a lease extension (with the consequent peppercorn rent), before putting the property on the market.

1. Check ground rent clauses

- If the property is a house - question why the freehold is not being sold, rather than a leasehold interest
- Check the CML Handbook and your client's lender's Part 2 requirements on the issues of ground rents, length of lease term and fees payable under the lease
- Check if the ground rent is over £250 (£1,000 in Greater London), and whether it will increase at any time in the future
- Is the ground rent capped - either at a percentage of the property value or the sums mentioned above?
- If it will increase, will it increase by indexation or by doubling every ten or 20 years? Perhaps use the spreadsheet to see the effect of doubling.
- If indexed - is this a recognised index such as RPI
- If indexed - is the index acceptable to lender?
- Show the clause to the client, explain the risks mentioned on the previous page
- Ask the valuer to comment on the effect of the increasing ground rent on the valuation of the property now, and in the future, and whether it will affect the marketability of the property.
- Ask the valuer to comment on the possible effect on the purchase price of the freehold or a lease extension
- Again, refer the advice of the valuer to the lender and the client
- Also consider any provisions regarding fees for registration of assignments or other events, and consider whether can be capped as suggested by the UK Finance/CML note.
- Warn the client of the serious risks of accepting an unacceptable ground rent and finding that the property is unsaleable, or unmortgageable, or has a significantly reduced value
- Perhaps also give the client the SLC Leasehold and Ground Rent client guide.
- Emphasise to the client that they must consider all of this carefully, and that they must ask you (or the valuer as appropriate) any questions they might have as a result.

2. Possible Solutions - renegotiate terms

- If a house, advise the client to insist on the freehold
- Ask the landlord/seller to agree to vary the lease terms to acceptable terms
- Cap any increases of the ground rent at £250 (£1,000 in London)
- Cap the rent to, say, 0.1% of the value as suggested by Nationwide
- Check the maths on any indexation provisions. Ask the client and the valuer to check it too.
- Ultimately, advise the client not to proceed if no solutions are possible

3. Existing leases - Extend?

Your client may have an existing lease with onerous terms, and the landlord may refuse to renegotiate the terms, or may be seeking an exorbitant payment as consideration.

In those cases the client may consider making an application under the Leasehold Reform Housing And Urban Development Act 1993 for a lease extension (technically a surrender and re-grant). The new term will be 90 years plus the existing term and, importantly, the ground rent of the new lease must be a peppercorn.

4. Lender and client attitudes

We have all had clients who fall in love with a property and are deaf to all your warnings and advice. However much as your client wants to ignore the issue, it is likely that buyers' and lenders' attitudes are likely to harden against unacceptable ground rents over the coming years.

Such clients must have clear advice, that is carefully recorded in writing, to prevent any future allegations that you failed to point out the potential problems when they decided to proceed against your advice.

Different considerations will apply to different lease terms and different borrowers and lenders. The lender's attitude to a lease should not be taken as the only consideration as their interest in the property is generally limited to its value and saleability when contrasted to the amount of loan.

Your client, on the other hand, will be also concerned with the cost of paying the ground rent, paying fees for consents and maintaining the full value paid for the property, regardless of the loan to value ratio.



New build leasehold properties

Background

This document provides information on the issues relevant for lenders and their advisers concerning lease terms for **new build leasehold properties** in England and Wales, which may have a particular implication for the value of the property and for affordability of the mortgage loan.

This document is for information only. It does not form part of, or override any CML member's lending policies or guidance to their professional advisers such as valuers or conveyancers. Nor does it take precedence over relevant clauses of the CML Lenders' Handbook, such as s 5.14.1 and 5.14.9.

The document does not address all lease terms. It is the responsibility of the legal adviser to advise the lender client on the lease, in accordance with the CML Lenders' Handbook, and any special instructions. **It remains the responsibility of the prospective purchaser to undertake their own investigations into the property they wish to purchase.**

*NB: It is important to note that the considerations and policies of individual lenders for lending on **existing leasehold property** and **shared ownership property** may differ, particularly around acceptable lease length, although the overarching considerations will be the same.*

Overarching considerations for lenders

Affordability

Lenders need to establish if the lease will have any impact on the borrower's affordability. It is a regulatory requirement for lenders to take account of all known future changes to a borrower's income and expenditure that could affect the affordability of their mortgage. As such, understanding the level of ground rents, how they increase over the mortgage term and other known charges due under a leasehold agreement, are relevant to lenders' assessments of affordability.

A lender's risk might also be increased if ground rent, or other charges are disputed by the leaseholder borrower in the future and the borrower does not pay while in dispute, as in such situations the lease could potentially be forfeited and the lender's security put at risk.

Property value and saleability

If ground rents and other charges appear to have an impact on the value and saleability of the property, lenders may, together with other matters, take this into consideration in deciding whether, and how much, to lend. **Lenders will rely on the advice of professional advisers, particularly the mortgage valuer, here.**

The length of the lease term also has relevance to the value of the property, as at a certain point, it may be necessary to negotiate and pay for an extension of the lease to preserve the property's value for the future.

General points

- Given that lenders must consider both affordability of the borrower, and the sustainability of the value of the property, lease terms which involve obligations for future payment, such as ground rents, are more likely to be considered acceptable for lending purposes if they are set at levels that will not materially change mortgage affordability in the future, or impact on the value of the property; and that the lease length is suitably long (i.e. is granted for hundreds, rather than tens of years).
- Lenders may query why a property is offered as leasehold. This is particularly so for leasehold houses.
- It is important that lease information for new homes is made available as early in the home buying process as possible, so that conveyancers and valuers can provide advice and lenders can make appropriate lending decisions.

- In relation to ground rents, lenders would expect to see nominal ground rents, reflecting the origins of the ground rent being 'peppercorn' in nature.
- Under current leasehold legislation, there are certain provisions which present a risk that the lease may be terminated or forfeited by the landlord (freeholder), leaving the property owner without a leasehold interest, and the lender mortgagee without a security. Therefore, lenders will expect that a conveyancer acting on their behalf advises on such risks and how they might be mitigated. An example is the relevant provisions of the Housing Act 1988 in relation to the creation of an Assured Tenancy where the ground rent exceeds £250 per annum or £1000 in Greater London.

Specific considerations

Lenders will expect professional advisers such as conveyancers and valuers to consider:

- The length of the initial lease term granted. As a general principle, longer lease terms will help sustain the property's value for longer, as there should not be a need to seek an extension of the lease in the medium term (i.e. over the term of the mortgage). Lenders using the CML Lenders' Handbook already stipulate a **minimum lease residue requirement** (see s 5.14.1 of the CML Lenders' Handbook).
 - Lenders recognise that there may be different lease lengths for houses and flats.
- The mortgage term in relation to the lease term, with particular regard to a likely review of the lease once 80 years or less are remaining.
- The initial annual ground rent figure. Professional advisers should take into consideration:
 - the level of the ground rent in relation to the property's market value,
 - the type of property (e.g. a flat or a house)
 - whether the ground rent is fixed or rises periodically,
 - If the ground rent does rise periodically, the formula by which it rises.
 - Where the property value is below £100,000, some lenders may wish to see a de minimis maximum initial ground rent figure (e.g. £100) is applied.
 - Whether the ground rent figure is at a level which triggers legislative provisions (such as under Part 1 of the Housing Act 1988), potentially creating a risk for the lender's security.
- The ground rent review formula (if not a fixed figure). Professional advisers should take into consideration:
 - The CML Lenders' Handbook at s 5.14.9, which provides that lenders will accept a periodic increase in ground rent, provided that the amount of the increased ground rent is fixed or can be readily established and is reasonable.
 - Where the formula is one which uses increases in line with an index, whether the index is a recognised UK index and is appropriate and/or acceptable to them. Some lenders may also expect a cap on the maximum ground rent amount, to guard against the ground rent reaching an unreasonably high sum, which could impact on the property's value, the continued affordability of the mortgage and the future saleability of the property.
 - Some lenders may be concerned to see the use of compounding formulas, or the use of minimum increases, in conjunction with an index-linked formula.
 - Where the formula does not link with a recognised index, and instead uses a multiplier (e.g. doubles) at set intervals, the frequency of the rent review intervals. There is no single industry view on a minimum acceptable frequency, as it may depend on other factors such as the initial amount of the ground rent, and whether there is a cap on the number of times the rent is reviewed.
- Other fees charged under the lease
 - Where other fees are charged under the lease (for example, on a transfer of equity) lenders will expect that these are set at reasonable levels. Where the fees follow the ground rent formula (for example, if they are set at 50% of the prevailing ground rent), lenders will have similar expectations as set out above for ground rent formulas.

Ground Rents - Client Guide

What are they? | Ground Rent Traps | Possible solutions

What is a ground rent?

If you buy a house or a flat that is leasehold the lease will require you to pay a small amount every year called the 'ground rent'. This may be a nominal, or 'peppercorn' rent, that you don't actually have to pay to the landlord. However, it might be as much as £100 or £200 pounds every year, which you must pay on time. The landlord's interest in the property is called the 'reversion'.

If you do not pay the ground rent the landlord can sue you for it as a debt. However he could also seek a court order for possession of your house or flat.

What's in it for the landlord?

The reason builders want to sell houses and flats on a leasehold basis is so they can eventually then sell the 'reversions' (meaning the right to collect the rents) for hundreds of properties to investors for a substantial amount of money.

Investors can also make money by selling the freehold of a house to you or selling an extension of your lease.

The lease will also require you to ask for the landlord's consent every time sell, mortgage, or make alterations to the house or flat. The landlord will make money from charging you fees every time you make an application. You will also have to pay the fees of the landlord's surveyor and solicitor. These can be significant amounts, and there is very little control over how much any of these charges are.

Do I have to buy a leasehold?

If you are buying a new-build or existing apartment then, in general terms, this must be leasehold. See our 'Leasehold - Client Guide' to learn more about leaseholds.

If you are buying a new-build house there is rarely and reason for this to be a leasehold, and, if you have a strong bargaining position with the seller, you could insist on buying the freehold.



The problem of escalating Ground Rents

There is nothing wrong with a lease that reserves a small ground rent, say £50 per year, or a 'peppercorn rent'. The problem that has appeared over the last year or so is where, under the terms of the lease, the ground rent increases to an unreasonable amount. For example, the lease may say the ground rent doubles automatically every ten or twenty years. This might sound reasonable at first sight, but over 120 years a ground rent of £250 that doubles every 10 years would become £1,024,000! In contrast if it had increased by the average inflation rate it would only be £8,600 in that time - see below.

Year of Term	Year	Ground Rent	Increase at 3% RPI
0	2017	£250	£250
10	2027	£500	£336
20	2037	£1,000	£452
30	2047	£2,000	£607
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60	2077	£16,000	£1,473
70	2087	£32,000	£1,979
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In the News....

The Guardian Newspaper campaign against high ground rents on new-build properties gives these examples:

Buyers of a £101,000 flat in Dudley built in 2010 by Taylor Wimpey found that the ground rent was set to spiral to £8,000 a year. The couple are now trapped in an apartment they can no longer sell because the ground rent review clause in the lease is preventing lenders approving a mortgage for their buyers.

Another buyer of a £200,000 new mid-terrace three-bed house in Bolton, built only six years ago, has a ground rent that by 2060 will be £9,440 a year. Potential buyer's solicitors have told their clients not to touch it, making it almost unsaleable.

Others have revealed how houses were sold by developers with the promise that a 999-year lease was "virtually freehold", only to discover that buying out the lease just a few years later was three or four times more expensive than promised.

Government Action - when?

The Government has published a white paper promising a forthcoming consultation on reform to the leasehold system to stop buyers being exploited. However it may be many years before this is implemented, and it might not be retrospective.

Possible Solutions - Renegotiate terms

- If buying a house, insist on the freehold
- Ask the landlord/seller to agree to vary the lease terms to acceptable terms
- Cap any increases of the ground rent at £250 (£1,000 in London)
- Check the maths on any indexation or doubling provisions. Ask the valuer to check it too.
- If the seller won't change the terms - don't buy it
- If an existing lease of an apartment, extend the lease under your statutory rights, which will reduce the ground rent to a peppercorn

Other problems with high or escalating ground rents:

1. The landlord can repossess your property if you don't pay the ground rent

If you don't pay the ground rent, then the landlord can sue you for it, but they can also claim possession of your property, without compensating you at all for the loss of your house. Now normally the risk of this ever happening is low, since all you would have to do is pay the arrears of rent, and the court would exercise its discretion not to give the landlord possession of your property.

However, because of a legal anomaly, if by that time the ground rent is now more than £250 (or £1,000 in Greater London) the lease would be deemed to be an 'Assured Tenancy' (like the usual tenancies given to buy-to-let tenants). This would mean that the court would have no discretion, and the landlord would be entitled to a mandatory possession order. You would lose your home and the landlord would not have to compensate you for its value.

The problem is that although the rent might start off as less than £250, if the lease says the ground rent will increase regularly every few years by a formula or percentage, then the ground rent might eventually be more than this amount. This would mean you would be at risk of losing your property if the rent isn't paid. Lenders will not lend on leases where there is this risk.

2. The cost of extending your lease or buying the freehold

Many tenants of leasehold houses have the right to buy the freehold, and many tenants of leasehold apartments have the right to claim an extension of their lease by 90 years.

The price you pay is set by a statutory formula involving the length of the lease, the value of the ground rent as well as the value of the property. A high or doubling ground rent could mean that the price of extending the lease or buying the freehold may be much higher than you would expect. The official Leasehold Advice Service website www.lease-advice.org contains a calculator to help you assess what this price will be. There are many specialist surveyors who can advise you on what the likely cost would be. Your conveyancer may also be able to help advise you on this.

3. Your property may become worthless or unsaleable

Many lenders have decided not to lend on properties where the ground rent is initially high, or could double or increase to an unreasonable amount. They may also refuse to lend where they consider that the length of the lease is too short, or the charges for consents of notices under the lease could be excessive.

Many owners of leasehold properties with unacceptable ground rent provisions have found their flats or houses are unsaleable, or the value is much less than they paid. Your conveyancer can point out any unreasonable terms and you should ask your valuer for advice on the effect on value. Your conveyancer cannot advise you on matters of valuation.

