

SERVICES TO LEASEHOLDERS UNDER
THE LEASEHOLD REFORM ACTS

BUYING A LONGER LEASE OF A FLAT

Freehold and Leasehold

House ownership in England is usually on a freehold basis. It is the property itself, ie the bricks and mortar and the garden, that is owned. Freehold ownership effectively means outright ownership forever.

Flat ownership is different because flat owners rely on at least one other owner for support or protection, so they need that other owner to maintain their property properly. The problem with freehold ownership for flats is that positive covenants in freehold titles are only enforceable against the original purchaser. This is why virtually all flats in England are held leasehold (even if "with a share of the freehold") so that the other owners can be forced to do something if necessary.

However with a leasehold, the owner does not own the 'bricks and mortar' but only a right to live in the property for the unexpired term of the lease. At the end of that time, the owner has no further rights and ownership of the property passes back to the landlord.

Usually a ground rent is payable under the lease and, in some cases, the lease provides for the ground rent to rise periodically. Sometimes the increase is to a fixed amount, but occasionally the way in which the new rent is to be calculated leads to a very large increase in the rent, much larger than general inflation would suggest and occasionally even larger than the general rise in property prices.

One problem that besets all leaseholders is that, although they may have paid good money for the lease and have had no difficulty in raising a mortgage, once the remaining term drops below 60 years or so it may become very difficult to re-mortgage in the usual way. Also in recent years some freeholders have discovered they can make 'easy money' by setting high rents with frequent increases.

Rights to Buy

To combat the problems of leasehold ownership, the Leasehold Reform Act of 1993 gave lessees of flats a right to extend the lease of their flat by 90 years and to reduce the rent to nil. This applies to lessees which are companies, persons living abroad and people with second homes.

The Leasehold Reform Acts give residential lease owners a right of compulsory purchase. That's a powerful right. Outside leasehold reform, it can only be exercised where companies or individuals cannot be allowed to obstruct the development of major schemes being created for the public good. The right puts lessees, who are mostly private individuals, in the same position as public and statutory bodies - the only ones which can exercise the general right of compulsory purchase.

The Price and the Opportunity for Financial Gain

The aim of all compulsory purchase legislation, including the Leasehold Reform Acts, is to ensure that those from whom property is being taken against their will, are properly compensated. In essence, the Leasehold Reform acts say that the landlord who has to sell the whole or part of his interest, is to be paid the value of that interest as if it were being sold to another investor and, except where the lease has more than 80 years still to run, 50% of the marriage value. The 50% retained by the lessee will be partly used to pay the professional costs of the claim, but there may be an amount left over which is, initially, only a paper profit, but becomes cash when the flat is sold.

Disputes are resolved by an independent First Tier Tribunal (FTT).

For those leaseholders who are either paying a high ground rent or who face a large rent review, there are additional benefits:

- 1 They can convert the payment of rent throughout the lease to a lump sum. That sum can be covered by a mortgage which, in normal times, is usually at a

beneficial compared to general interest rates and for a fixed term, often shorter than the lease.

- 2 A high ground rent (or the threat of one) depresses the value of the lease. Without the rent, there is an increase in the value of the property and then that higher value grows with the general increase in house prices.

Who Has Rights

A lessee who has been the registered owner of the lease for 2 years, has the right to buy a longer lease¹ of the flat. The personal representatives of a lessee who qualified before death, can exercise the right during the 2 years after the death.

The lease must have been granted for longer than 21 years, but it does not matter how many years are left on the lease. The rent is irrelevant.

The Process

The first step is to send a formal claim to the landlord which must include a financial offer. Making the claim obliges the lessee to pay most of the landlord's costs (see below). After a couple of months, the landlord must accept or deny the lessee's right to buy and say which parts of the offer are acceptable. For those parts which are not acceptable, counter-offers must be made.

There is then a period during which negotiations take place to see if the terms of purchase can be agreed. An application must be made to the local FTT within 6 months of the counter-notice, to determine the terms of purchase or the claim is deemed to have been withdrawn. Modest fees are payable to the FTT.

When terms have been agreed or determined by the FTT, the legal process continues until the new lease is granted. There are more statutory timescales at this stage but, broadly, the period from the agreement of all the terms of purchase to completion is about 2 to 4 months.

The whole process takes about 12 months but can last longer. A lessee can withdraw a claim at any time before completion, but has to pay the landlord's costs and no further claim can be made during the next 12 months.

The Valuation

The price is calculated at the date the claim is made. The 'building blocks' of most of the calculations are:

- the value of the claimant's leasehold in the flat currently and after the claim
- the value of the rent payable by the claimant
- the value of the landlord's right to repossess the flat at the end of the lease
- marriage value

¹
90 years longer than the existing lease at a nil ground rent throughout

'Marriage value' is released or created when the claim completes because, when two interests in a single property are joined up (or married together) they are worth more than the separate components. Normally 50% of the marriage value is payable. However, if the lease has more than 80 years unexpired when the claim is made, no marriage value is payable (even though it exists) because the marriage value will only be a small amount and will probably be all eaten up by the costs.

Because the values are assessed at the date of the claim, any rise or fall in the market during the process period, is irrelevant.

The value of improvements made by tenants is to be ignored so that the tenant does not 'pay for the improvements twice'. The cost of the improvements (either when they were actually carried out or, if they were to be carried out again) is not relevant. The discount is the value that the improvements add at the claim date. Improvements carried out many years ago probably require 're-improving' so add no value. However space added

almost always adds value, although the opportunity to add the space is part of the 'unimproved' value.

The Professional Costs

As soon as a claim is made, the lessee is responsible for the landlord's reasonable costs in dealing with the claim, whether the claim completes or is withdrawn. Those are the landlord's valuation and legal costs, but not the costs of negotiating the premium or anything connected with an application to the FTT. The FTT determines what is reasonable if it cannot be agreed.

A lessee will also incur legal costs in making the claim, taking all the necessary steps to make the claim safe and keep it 'alive' and in agreeing and entering into the new lease. Most lessees also take their own valuation advice and get the valuer to negotiate the price or premium.

Further Claims

Once a new lease is granted, the lessee can make another claim to add a further 90 years to the lease. This is useful where the original lease is short and the new lease has less than 125 years or so to run. The lessee can also take part in an enfranchisement of the whole block of flats, even if a claim has been made for a longer lease.