



Leasehold Reforms on the Horizon

The UK Government's recent announcement that legislation to significantly reform leasehold property ownership is on the horizon could impact mortgage lenders, landlords, portfolio investors and all those operating within the 'living' sector.

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The UK Government's recent announcement that legislation to significantly reform leasehold property ownership has the potential to impact for mortgage lenders, landlords, portfolio investors and all those operating within the 'living' sector.

While leasehold is generally the appropriate form of land ownership for properties within communal buildings and estates, a trend had emerged for new-build houses to be sold as leasehold properties. The reason was commercially motivated.

Developers would sell the leasehold title to the house owner and then make a further financial return by selling the freehold title to a third party – often an investor owning a portfolio of such properties.

Some homeowners discovered that their lease provided for (initially very low) ground rents to increase at a significant and unexpected rate, with the consequence of tying them into leases which were becoming unaffordable and rendering the properties un-mortgageable/unsaleable. Whilst the statutory option to extend a lease and to convert the rent payable to a peppercorn, has been available to owners of leasehold houses and flats for some time, it has been perceived to be a costly and complex option.

Recent years have also revealed a further, no doubt unintended, consequence of onerous ground rent clauses: the assured shorthold tenancy 'trap'¹. This backdrop has resulted in wide-scale leasehold reform being high on the Government's political agenda.

In a headline-grabbing announcement² on 7 January 2021, the Housing Secretary confirmed that the first step in the reforming legislation – setting future ground rents to zero – will be brought forward in the upcoming

session of Parliament. The announcement also covers other proposals (as to which, see below).

However, with no draft bill having been published, and with no reference to the detail of the legislation, it is not yet possible to provide any concrete information or advice. There is also currently no indication as to actually when any legislation will come into force. In all likelihood, it will not be until late 2022 at the earliest.

In an attempt to get behind the headlines, however, this article summarizes our understanding of the Government's various proposals so far, and seeks to highlight potential impacts for lenders, investors and others across the 'living' spectrum.

Proposals for reform

Key proposals for reform announced by the UK Government on 7 January 2021 include:

- Leaseholders of houses and flats will be able to extend their lease to a new standard 990 years (a virtual freehold) with zero ground rent³.
- Zero ground rents payable when a leaseholder chooses to extend their lease and an online calculator to make it easier for leaseholders to discover how much it is likely to cost them to do so.
- The abolition of 'marriage value' and potentially additional compensation to the landlord⁴ to ensure that the cost to the leaseholder of a lease extension is cheaper and also more transparent.
- Leaseholders will be able to agree to restrictions on the future development of their property, so as to avoid the possibility of having to pay a





'development value' premium on extending their lease.

- Changes will be introduced to ensure that leasehold owners of retirement properties have the same rights as other homeowners.

Further changes, in particular in relation to the promotion of commonhold [5] as an alternative form of property ownership, are likely to be announced in due course.

What are the issues of interest to lenders and investors?

The Government's proposals are likely to be popular with house, flat and retirement property leaseholders (albeit some of the ultimate benefits for homeowners may not, in reality, amount to all that the headlines would suggest – see below). But what are the potential implications for other key stakeholders in the living sector (such as lenders, landlords, portfolio investors and developers)?

The impact on lenders is likely to be negligible or positive

- The majority of lenders operating in the UK housing market today already have sufficient safeguards built into their underwriting criteria and mortgage conditions to enable them to lend on certain leasehold properties without fear of the secured asset's value 'wasting' to an unacceptable degree.
- However, the ability of all leasehold homeowners to extend their leases more easily and more cost-effectively is likely to open up and stimulate the market by increasing – potentially to a significant extent – the number of mortgageable leasehold properties.
- It is unlikely that a lender's duty to a borrower to achieve best price on a repossession sale would

require them to extend a lease [6], even if the proposed new process is simpler and less costly.

- Lenders have, to date, dealt with the so-called 'assured tenancy trap' by instructing conveyancers as to what is and is not acceptable security by reference to ground rent levels and ground rent review provisions, and by the taking out of indemnity insurance. It is to be hoped that zero/capped ground rents will significantly reduce the number of instances in which the assured tenancy trap could arise in future – particularly if the government also lifts the current assured tenancy low rent thresholds as part of the reforms.

The impact on landlords and freehold portfolio investors is likely to be negative

- Landlords/investors will be interested to see how the proposed online calculator will work in practice and wish to ensure that the loss of an uplifted premium for hope value is properly compensated for. Otherwise they are likely to lose out on income as a result of new methods of valuation/calculation of premiums and by virtue of the fact that, going forward, an extension will in practice only happen once per property.
- Whilst proposed reforms were clearly intended to address the issue of unscrupulous parties seeking to profit from onerous escalating ground rents, 'blanket' reforms are likely to detrimentally affect the value of portfolios held by landlords/investors who have sought to responsibly maintain assets on ground rents which were reasonably or even conservatively set.
- There is likely to be a particular concern that certain legitimate, socially-responsible, freehold residential owners (such as local authorities, housing associations and the like) may be detrimentally affected. It remains to be seen

whether legislation will ultimately contain any carve-outs for these types of owners.

The impact on developers is likely to depend, to a significant extent, on their own reaction and approach

- A number of housebuilders/developers reacted some years back to the fact that issues associated with leasehold houses and onerous ground rents were causing problems for homeowners, with many ceasing to offer leasehold and/or escalating ground rents on some or all of their developments. Others entered a voluntary programme to retrospectively re-set ground rents. Many others had not sought to make significant financial gain from freehold reversion sales to portfolio investors and/or from ground rent income in the first place. The impact of the Government's proposals on developers is therefore likely to be minimal.

In conclusion

Leasehold reform is a hugely ambitious and wide-ranging aspiration, and the UK Government's recent announcement is simply the first step towards the implementation of yet-to-be-drafted legislation to make reform a reality. It is likely to be some time before the legislation takes effect or indeed before the content of it is crystallized, due to the inevitable parliamentary debate it will attract.

As the Government's plans in relation to leasehold reform are revealed and refined over time, Walker Morris will continue to monitor and report on developments. If you would like any further advice or assistance in the meantime, in relation to any aspect of the proposals, the potential impact on your business or on policies and procedures, please do not hesitate to contact Karl, Louise or Sandip.



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Karl Anders is head of Walker Morris' Housing Management & Litigation Team advising social and private sector landlords on all areas of residential landlord and tenant law. He is particularly recognized for his expertise in respect of occupational tenancy possession actions relating to all types of tenure, possession claims against trespassers, lease forfeiture and anti-social behaviour injunctions.

Amongst Karl's clients are lending institutions, fixed charge receivers, registered providers of social housing, nationally recognized letting agencies and the largest UK supplier of student and key worker accommodation.

Karl has been instrumental in developing the firm's case management system for arrears-based residential possession claims (Freehome™). This innovative service provides clients with secure online access to up to date information and reports regarding their cases and has a direct interface with the HM Court Service's PCOL website.



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Louise Power is Head of Walker Morris' Banking & Finance Litigation team and has a varied practice which in recent years has focused on financial litigation involving secured lending. Instructed on cases ranging from multi-jurisdictional frauds to surveyor's negligence via non-standard possession actions, Louise has become a trusted advisor to the financial institutions with whom she works. Clients comment on her integrity and the way she takes the time to understand their business needs and objectives.

Louise also specializes in real estate litigation and acts for developer clients on disputes relating to issues of construction quality and consumer complaints. Following the repeal of the Property Misdescriptions Act, Louise has presented to the housing industry in conjunction with the Home Builders Federation and has devised an e-learning training programme for developers in relation to the Consumer Protection Regulations 2008 to allow desktop training on this complex area of law.

A member of the Property Litigation Association and the Professional Negligence Lawyers Association Louise is regularly invited to speak at training events and conferences where comment is often made about her down-to-earth, approachable style as well as the obvious depth of her knowledge.

Louise's experience is wide-ranging, but the common element throughout all her work is her professional, client-focused, tenacious approach.



Sandip Singh
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Sandip Singh is a Director in Walker Morris' Banking Litigation team and has experience of acting for a number of lending institutions on a wide range of disputes including complex and high value frauds, elaborate and multi-party frauds and the misappropriation of funds by solicitors, borrowers and third parties. He also acts in cases where the intended security has not been obtained.

He is experienced in claims against solicitors for fraud, breach of fiduciary duty, negligence, breach of retainer and breach of trust. He also acts in valuer claims in negligence and breach of retainer. Sandip acts in cases involving identity theft for lenders and property hijacks by fraudsters. He also has experience of applications and claims to the Land Registry for indemnity payments, rectification, alteration of the register and dealing with wrongly discharged mortgages.

Sandip acts in relation to non-standard title defect claims and non-standard repossession claims including claims where vesting orders or declaratory proceedings are required. He also acts where repossession claims have become complex or sensitive.

He has previous experience as a Real Estate Litigator with a commercial, landlord and tenant and residential property litigation background and so is able to provide pragmatic and cost effective solutions to a wide range of issues affecting lenders

Reference	
1	Escalating ground rents bring more residential leases within the definition of an assured shorthold tenancy. As a result, more leases become vulnerable to forfeiture via the mandatory 'arrears' ground for possession under the Housing Act 1988, regardless of the impact on the leaseholder or mortgage lender.
2	'Government reforms make it easier and cheaper for leaseholders to buy their homes', GOV.UK. Available at: https://www.gov.uk/government/news/government-reforms-make-it-easier-and-cheaper-for-leaseholders-to-buy-their-homes
3	Currently, leaseholders of houses can extend just once for 50 years with a [potentially escalating] ground rent and leaseholders of flats can extend multiple times for 90 years with a nil/peppercorn ground rent.
4	Existing costs to the leaseholder often include marriage value. Marriage value is the difference between the higher value of the property if it was in single ownership and the lower value of the property when it is owned separately by both a landlord and a leaseholder.
5	Commonhold combines freehold ownership of individual units with ownership of common parts through a commonhold association (CA). The CA is funded by each of the freeholders and controls the management of shared parts in accordance with a statement agreed between them.
6	(if new legislation allows them to do this, whether as a mortgagee in possession per se, via a Power of Attorney in the mortgage conditions, or via any appointed Law of Property Act Receiver).