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NATIONAL RESIDENTIAL LANDLORDS ASSOCIATION

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Leasehold Reform What do changes mean for you?

Property

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A LANDMARK MOMENT FOR LEASEHOLDERS?

What does the Government's new Leasehold and Freehold Reform Bill hold and how will it affect you?

WORDS BY NIC PATON

"Today marks a landmark moment for millions of leaseholders," announced Housing Secretary Michael Gove in November last year as he introduced the Leasehold and Freehold Reform Bill to Parliament, arguing it will address historic imbalances between leaseholder and freeholder and "give homeowners a fairer deal, greater protections and more rights".

But what does this mean for landlords, both those who let leasehold properties and those who own the freeholds of apartment blocks containing multiple leasehold flats?

Assuming it becomes law (and in an election year, that isn't a straightforward assumption to make), will it also be a 'landmark moment' for the private rented sector (PRS)?

John Socha owns this Northampton property block, which has a fixed ground rent of £12 until 2074

Dr Mark Andrew

The first thing to recognise about these proposed reforms – which will standardise lease extensions, reduce ground rents and improve transparency over service charges (see the panel below for more detail) – is that they are not as far-reaching as the market had once been expecting, or even fearing.

"Overall, what we're anticipating is not a huge change. It is not what the Government billed for years was going to be a root-and-branch reform of leasehold, and not the abolition of leasehold and the replacement with commonhold that we thought might be coming," says Chris Norris, director of policy and campaigns at the National Residential Landlords Association (NRLA).

THE LEASEHOLD AND FREEHOLD REFORM BILL – THE MAIN FACTS

The Leasehold and Freehold Reform Bill was introduced to the House of Commons on 27 November 2023. The bill's second reading was held on 11 December 2023.

At time of writing, it was in its committee stage, and being examined by the Public Bill Committee. This was expected to report back to the House of Commons. There will then be a third reading before it goes to the House of Lords for further consideration and debate. The bill's main provisions are to:

- Make it cheaper and easier for leaseholders in houses and flats to extend their lease and buy the freehold
- Increase the standard lease extension term to 990 years, with ground rent reduced to a 'peppercorn', or a token or nominal figure upon payment of a premium
- Change the qualifying criteria to give more leaseholders the right to extend their lease, buy their freehold and take over management of their building
- Improve the transparency of service charges and ensure leaseholders receive key information on a regular basis
- Give leaseholders a new right to request information about service charges and the management of their building
- Improve the transparency of administration charges and buildings insurance commissions
- Ensure leaseholders are not subject to any unjustified legal costs and can claim their own legal costs from their freeholder
- Give freehold homeowners who pay charges for the maintenance of communal areas and facilities on a private or mixed-tenure residential estate the right to challenge the reasonableness of charges and the standard of services provided
- Improve the transparency of estate charges and ensure freehold homeowners receive key information on a regular basis
- Ensure a rentcharge owner is not able to take possession or grant a lease on a freehold property where the rentcharge remains unpaid for a short period of time.

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A provision of the bill is to make it cheaper and easier for leaseholders to extend their lease and buy the freehold

The expected abolition of marriage value (otherwise known as the premium paid to extend a lease) is also not spelled out within the bill even though, as Jeremy Dharmasena, head of Knight Frank's leasehold reform and litigation team, highlights, the way the bill is drafted does mean that, effectively, it will be abolished.

Its research suggests this will probably increase leasehold property values by about 10 per cent.

"We now have a situation where ground rents are going to be amended in some form – and at the moment we don't know exactly how – but if they're reduced to a peppercorn, then it's happy days as far as those [leaseholder] landlords are concerned. They would no longer have a liability and so it makes sense they're going to be delighted," Jeremy points out.

LEASEHOLDER LANDLORDS

Reducing the premium for buying out a freehold or extending a lease and standardising lease lengths to 990 years will mean leaseholder landlords, especially those whose properties were on short-term leases of diminishing value, may find they have, in effect, a sudden windfall gain, agrees Dr Mark Andrew, senior lecturer in real estate finance at Bayes Business School (formerly Cass) in London.

This may enable them either to sell up, perhaps if they were thinking of exiting the market anyway, or to reimagine their property as a longer-term, higher-end investment. "There might be an incentive for landlords to refurbish the property and then let it out to a completely different income group," Mark says.

> "We now have a situation where ground rents are going to be amended in some form"
>
> JEREMY DHARMASENA

Jeremy Dharmasena

The potential downside of this, he contends, is if it: a) reduces stock and therefore adds further pressure to private rental market supply; or b) reduces access to affordable leasehold properties, whether for tenants, private buyers or landlords.

Conversely, however, the possible negative impact on freehold owners and managers of large blocks of flats who benefit from multiple ground rents does need to be taken into account, argues Jack Spearman, chair of leasehold reform at the Residential Freehold Association. This is not least because it could create a knock-on headache for leaseholder landlords.

Trusts or pension funds – some of which own and provide management oversight of thousands of apartment buildings – could find themselves suddenly with an expensive asset on their hands that is no

"THERE IS A CLEAR CASE FOR LEASEHOLD REFORM"

Gloucestershire-based landlord David Howard specialises in buying, renovating and then renting out older leasehold retirement flats. He has a portfolio of around 130 properties that are dotted across England, most of which are outside London.

For him, reform of ground rents, especially if these are either abolished or reduced to peppercorn levels, would be broadly positive. "Obviously, anything that saves me money I'm going to be in favour of. But the devil is in the detail," he says.

Anything that simplifies the complexity, and expense, of extending leases would also be welcome. "At the moment, what is wrong, certainly in my world, is that if I wish to extend a lease – and some of my leases have only got 60 years left, so they're short leasehold – I have to pay five sets of fees," he explains.

"I have to pay my own lawyers, my own valuers, the freeholder's valuers and lawyers, and a fee as well. Yet, because the value of my properties is so low – we're talking here well under £100,000 – and the cost of hiring any lawyer or surveyor is a fixed element, the result is the cost to extend becomes prohibitive.

"So, a reform that says I can extend or, better still, buy out the ground rent on a formula, which therefore means I don't have to employ or pay valuers or lawyers, yes, bring it on, that'd be great. There is a clear case for leasehold reform because the system as things stand is being gamed; it is crazy," David says.

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longer bringing in an income. This could either force them into a fire sale or, even worse, into administration, he warns.

"You then, as a buy-to-let leaseholder, have to work out who's going to take on that freehold. You may suddenly have to become a very active participator in that property," Jack says.

"You may have to get all the leaseholders in the building together. You've then got to manage the freehold or appoint a managing agent; you've got to take on the liability and responsibility for things like fire regulations and building safety legislation," he adds.

"If you remove them [freeholders] from the market, then you can see that some properties may fall into disrepair because they are no longer benefitting from that management function. That might also result in the value of some properties falling, which will have a direct impact on rents," agrees Jeremy.

Leaseholder landlords are hoping for abolished or reduced ground rents

IMPROVING TRANSPARENCY

Nevertheless, for former solicitor-turned-landlord Suzanne Smith, creating greater transparency and accountability around ground rents and management and service charges will definitely be a positive.

Suzanne Smith

"As a landlord, I would never buy a leasehold property again, even with the new laws coming in; just because of the lack of control and because I had my fingers burnt," she says.

She recalls how investing in a three-bedroom, two-bathroom leasehold flat on a development in central Cambridge back in 2015 did not turn out to be the investment she'd hoped for because of the opaque way its service charges were calculated.

"The year after I bought the property – so, 2016 – the service charge was £1,473 a year, which seemed fine. But by 2019, it was £2,964. It doubled in three years in what was, remember, a period of low inflation," she explains.

"I wrote to the freeholder querying the increase and asked whether it was likely to go up again, because I needed to be able to budget. I was worried that, due to the increased service charge, I wouldn't get a very good net yield from renting out the property.

"All they kept saying was that they 'couldn't reasonably project the costs for the upcoming period'. So, for me, there was a real lack of accountability.

"IF IT BRINGS IN MORE TRANSPARENCY, THAT WILL BE POSITIVE"

Northamptonshire landlord John Socha owns 27 freehold blocks of flats across the county, containing some 420 leasehold apartments.

While he concedes the ground rent he receives as a result "is a nice little income", he nevertheless believes reforming ground rent to create more transparency and do away with unreasonable rises would be a positive move.

"I think by and large the reforms will be a good thing for landlords, if it's going to stop the doubling of ground rents every 10 years. In all the buildings I own, for example, it is written into the leases that the ground rent will only increase every 25 years, either by doubling or RPI over that period. I have one site set at £12 per annum with no increases for 99 years from 1975," he says.

One possibly overlooked issue within the reforms is their stated aim to ban 'opaque and excessive' buildings insurance commissions, he says. Yes, it will be positive if the reforms do away with sharp practices in this area, John concedes, but in his case the income he gets from this is used to the benefit of the leaseholders.

"That commission pays directly for one of my staff members. If there's a leak coming through the ceiling in your flat, she'll sort it out – get the water turned off, get a tradesperson in, ensure the people upstairs have fixed their leak, make the claim to the insurer, hire and pay the tradesmen direct," he says.

Overall, John believes the reforms, at least as things stand, won't make that much practical difference on the ground. "I don't think they will encourage that many freeholders to exit. It is just going to be a different set of rules to play by.

"Certainly, you do see some freeholders charging overinflated prices for simple things like repainting a building, ripping leaseholders off terribly. So, if it changes that for the better, and brings in more transparency, that will be positive."

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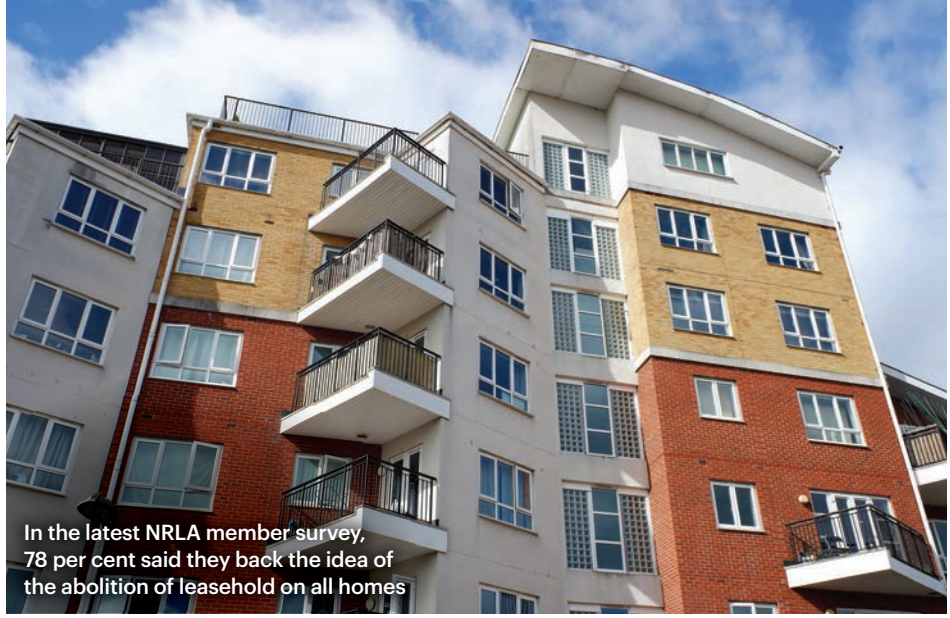

In the latest NRLA member survey, 78 per cent said they back the idea of the abolition of leasehold on all homes

GLOSSARY: SOME USEFUL LEASEHOLD TERMS

- **Collective enfranchisement.** The collective purchase by leaseholders (at least 50 per cent) of a freehold, normally in a building containing flats.
- **Commonhold.** A variant of freehold and introduced in the Commonhold and Leasehold Reform Act 2002. Each property owner in a block of flats is allowed to acquire equal rights to a part of the freehold along with an equal responsibility in the maintenance of shared areas.
- **Deferment rate.** Also known as capitalisation rate. This is the compensation payable to a freeholder for future losses resulting from a freehold purchase or lease extension.
- **Enfranchisement.** The purchase of the freehold of a leasehold house.
- **Ground rent.** A payment made by a leaseholder to a freeholder to cover the cost of the land the property is built on.
- **Marriage value.** The increase in the value of the property following the completion of the lease extension, essentially 'marrying' the freehold and the leasehold to reflect the additional market value of the longer lease. In practice, this is normally an additional cost paid by a leaseholder on extension of their lease.
- **Rentcharge.** Similar to ground rent, this is an annual sum paid by a freeholder to a third party who has no other interest in the property. It is also sometimes referred to as a 'chief rent'.
- **Right to manage.** Where a majority of leaseholders (again, at least 50 per cent) acquire from the freeholder the right to take over responsibility for the management of their building. This was introduced in the Commonhold and Leasehold Reform Act 2002.

"As a landlord, I would never buy a leasehold property again, even with the new laws coming in; just because of the lack of control"

SUZANNE SMITH

I paid it under protest, as I didn't really feel I had any other option.

"But at the end of 2021, I decided to sell, as I could see inflation was going up and I reckoned they would just use that as an excuse to put it up again," says Suzanne, who now has a portfolio of four freehold properties in Kent and also writes the blog theindependentlandlord.com, to help other landlords.

NRLA MEMBER SURVEY FINDINGS

With around 40 per cent of leasehold homes let in the PRS, the latest NRLA members survey, carried out just before Christmas, chimes with this desire for greater transparency and accountability within the leasehold market.

More than half of those polled (55 per cent) said they were renting out a flat or apartment with either a long lease of more than 125 years (26 per cent) or a shorter one (29 per cent). A total of 14 per cent owned leasehold houses, while just 12 per cent said they owned the freehold to a block of leasehold flats.

Of the leaseholders, 14 per cent are currently paying more than £250 ground rent per annum per property, 32 per cent £100 or more and 17 per cent £50–100. That makes it perhaps unsurprising that capping ground rents at peppercorn levels was broadly popular, backed by 43 per cent.

Nearly half (48 per cent) also complained that buying a freehold or renewing a lease was 'never' straightforward. This, again, was reflected in 78 per cent backing the idea of the abolition of leasehold on all homes and 53 per cent on all flats and apartments.

"Looking at the survey findings, the bill will be a net positive for most. We have a very significant number of landlords as members who are leaseholders and will likely welcome the provisions that will strengthen their position. And I think these reforms will potentially give them a bit more agency when it comes to the lease," emphasises Chris Norris.

"The ability to extend leases is a big change and that will have more of a systemic change in the market over the years. But it is not going to be a big bang that is going to change people's lives overnight. It is a good step, but it is just a step," Chris adds.

Finally, could the reforms be derailed by a general election and, especially, a Labour win? Chris, for one, thinks this is unlikely. "If they go for an autumn election, there is time to get this through. I would say it is probably 60/40 that it will get through," he says.

"I do think it is a priority for Michael Gove; I think he wants a legacy – he wants to be the guy who reformed renting and reformed leaseholds. But it does, of course, depend on when the election is called. If it does end up being in the spring, then all bets are off," Chris adds.

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