Escalating Ground Rents
Note for Licensed Conveyancers

Special Bulletin

Escalating Ground rents have been in the news for the last few years, 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 Law Commission promises firm proposals in late 2019 but many (including the MHCLG) have criticised their current proposals. Clients, lenders and valuers must all be involved in assessing whether this is an issue on all transactions, not just new-builds. This note contains a suggested Client Guide, and an Excel ground rent estimator. The Sept. 2018 Law Commission Consultation Paper proposals were heavily criticised by the Housing, Communities and Local Government Committee in March 2019. Formal proposals for reform are promised for late 2019, but it will be at least two or three years before any changes take effect.

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.