



LEASEHOLD – MORE REFORM ON THE WAY

What it will mean for landlords, leaseholders and tenants

There are some things about the UK, like Marmite and Boris Johnson, that foreigners find difficult to understand. One of them is the leasehold system. How can you own a house and yet not own the land that it sits on? How can you own a flat and not own the building? The system had a major reform 25 years ago with the 1993 Leasehold Reform Act, which gave leaseholders the right to buy their freehold or extend their lease by 90 years. Its introduction was followed by 10 years of to-and-froing in the courts and valuation tribunals — but the end result has been a system that works pretty smoothly for both landlord and leaseholder,

particularly in London, where most participants are relatively sophisticated consenting adults. If you were starting from here you wouldn't invent it — but from where we were, it works. Until now.

The cause of the upset has been the behaviour of some housebuilders. Ground rent escalation has been part of the warp and weft of development packaging — up to a point. Some, however, have used the leasehold system to foist on to unsophisticated buyers ground rent clauses that doubled every few years. The power of compounding is such that this made the properties they had bought almost unsaleable and certainly massively devalued. The result has been a storm of righteous anger that has extended way beyond the ethics of a few housebuilders to include the whole leasehold system and the relative rights of landlords and leaseholders. It won't be good news for landlords.

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A FLAWED SYSTEM?

The leasehold system has many flaws from the point of the leaseholder, who has become “the consumer” in the argument. A leasehold is obviously a wasting asset and there are two parties in the transaction whose interests are divergent — although in the case of the London estates with high standards, this point is debatable as it is those high standards for which leaseholders are paying a premium. And there is a generally held view that the balance of power between landlord and leaseholder is unequal — in the landlord’s favour. The press has certainly taken this view — and politicians read the papers.

Leading the charge has been the Leasehold Knowledge Partnership representing leaseholders. Within Parliament, the All-Party Parliamentary Group for Leasehold and Commonhold Reform has been promoting reform. Their combined efforts culminated in the 2017 government consultation paper entitled Tackling Unfair Practices in the Leasehold Market, which has resulted in an announcement that the government intends to ban leaseholds for the sale of houses and limit all future ground rents to a nominal sum. None of this has yet been enacted.

VALUATION TILTED TOWARDS THE LEASEHOLDER

More recently, the Housing Communities and Local Government Select Committee and the government have recommended that commonhold should become the preferred method of owning flats and the leasehold system phased out. In addition, the Law Commission has come up with proposals and options to make the process of enfranchisement quicker, easier and cheaper. It is this that is of most concern to landlords.

At the moment, enfranchisement valuations are based on market evidence and include marriage value — the increase in value of the property that occurs when the lease is extended or enfranchised by the leaseholder. The landlord currently takes half of this. There are two options being mooted by the Law Commission for the valuation of leaseholds. One is a “simple formula” that would either be a multiplier of ground rents or a fixed percentage of the freehold value. Either would be massively in the leaseholder’s favour. The alternative is a “market-based” valuation formula — but tilted heavily away from the landlord. Given the confiscatory nature of the “simple formula”, the likelihood is that a “market-based” valuation will be the final outcome — with marriage value potentially consigned to the history books.

Commonhold is very similar to methods of communal ownership used across the world, where it is known as “strata” or “condominium” title. Under it, owners of flats own the freehold and a share in a company that runs the building. Not much not to like here from a leaseholder’s point of view — but it didn’t take off after it was introduced back in 2002 as, surprise, surprise, developers preferred to sell a wasting asset and collect ground rents. It looks, though, as if its moment has come.

And the timing of all this? The consultation period is likely to last at least a year, with any bill likely to come before Parliament in 2021.

SHORTHOLD TENANCIES UNDER REVIEW

It is not only long leaseholds that are in the cross-hairs. With many more people renting for longer, the rental market is coming under government scrutiny. Since 1988, the private rented sector has effectively been de-regulated as both security of tenure and rent controls were removed. The government is proposing to take away the right of landlords to gain possession at the end of the contractual term of an Assured Shorthold Tenancy, unless there is a breach of terms or arrears of rent. There is no talk of rent controls — yet. Under a Corbyn government it would be a near certainty.

All this is part of a wider long-term trend. Over the past 30 years, “capital” has had a good run both in terms of accumulation and taxation. It’s now going the other way — and “capital” is likely to see its advantages trimmed back. In practical property terms, this is yet another blow to the buy-to-let market and we are seeing fewer and fewer clients buying residential for investment when the commercial alternative is so much more attractive. For residential landlords of both long and short leases, this is a changed world — and it’s not going back any time soon.