

SERVICES TO LEASEHOLDERS UNDER
THE LEASEHOLD REFORM ACTS

BUYING THE FREEHOLD OF A HOUSE

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.

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 new rent is to be calculated on a formula set out in the lease which 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.

Rights to Buy

To combat the problems of leasehold ownership, the Leasehold Reform Act 1967 lessees of houses have had a right to buy the freehold or, in a few cases, to extend the lease of their house. Companies, persons living abroad and people with second homes can buy the freehold of their house.

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 plus, except where the lease is very long, 50% of the marriage value.

The Acts dictate the way in which the price for the longer lease or the freehold is to be assessed and provides for disputes to be resolved by an independent leasehold valuation tribunal. The lessee 'retains' at least 50% of the marriage value (qv) but this will be partly eaten up by the professional costs of the claim. Anything left over is, initially, only a paper profit, but it becomes cash when the house is sold.

For those leaseholders who are either paying a high ground rent or who face a large rent review, there are additional benefits. The rent is paid from taxed income. On enfranchisement:

- i the rent is converted to the payment of a lump sum which can be covered by a mortgage. In normal times, mortgage interest rates are usually beneficial as compared to general interest rates, so the mortgage payment can be a smaller annual amount than the rent.
- ii The mortgage is repaid after a fixed term, typically 25 years, whereas the rent would have been paid throughout the remainder of the lease which would have much longer.

- iii A large ground rent depresses the value of the lease. Without the rent, there is an increase in the value of the property and it is then that higher value that 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. The personal representatives of a lessee who qualified before death, can exercise the right during a 2 year period after death.

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

There are tests to define a 'house'. Basically it must stand on the ground and be capable of independent redevelopment; this is so that the freehold in the property can be sold. If there is any built space below what appears to be a 'house', then technically it is a 'flat'. Potentially such 'flats' can group together to form a 'block of flats' but not more than 25% of the internal floor space of the block can be used for non-residential purposes.

The Process

The first step is to send a formal claim to the landlord. Making the claim obliges the lessee to meet certain costs incurred by the landlord as a result (see below). It is not necessary to make an offer. After a couple of months, the landlord must accept or deny the lessee's right to buy.

There is then a period during which negotiations take place to see if the terms of purchase (the legal transfer and the price payable) can be agreed. There is no time limit, but generally one party or the other applies to the First Tier Tribunal (FTT) (formerly the LVT) after a couple of months if the terms cannot be agreed. Modest fees are payable to the FTT.

When terms have been agreed or determined by an FTT, the legal process continues until the freehold changes hands. 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 claim can be withdrawn at any time before completion, but the landlord's costs have to be paid 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 values of:

- the claimant's current leasehold interest
- the claimant's freehold interest after the claim
- the rent payable by the claimant
- the landlord's right to repossess the house at the end of the current lease
- the potential to add value by altering or extending the house
- any marriage value

'Marriage value' is released or created when the claim completes because it is only the tenant who can marry up the leasehold with the freehold. 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. That is 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 the lessee or former lessees is to be ignored so that the tenant does not 'pay for the improvements twice'. The discount is the value

that the improvements add to the value of the house at the claim date. So the cost of the improvements (either when they were actually carried out or, if they were to be carried out again) is not relevant. 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 he incurs in connection with an FTT application. The FTT determines what is reasonable if it cannot be agreed.

A claimant will incur legal costs in making the claim, taking all the necessary steps to make the claim safe and keep it 'alive' and also in agreeing and completing the transfer of the freehold. Most claimants also take their own valuation advice and get the valuer to negotiate the price.