

Consultation for reform of residential ground rents

December 2023

The King's Speech on 7th November included reference to the government's long-awaited proposals for leasehold reform including an intention to consult "on capping existing ground rents to ensure that all leaseholders are protected from making payments that require no service or benefit in return". The consultation *'Modern leasehold: restricting ground rents for existing leases'* followed swiftly on 9th November 2023 and sets out proposals to extend the existing restrictions on the ground rent that new residential tenants can be charged, to include ground rents payable by existing residential tenants.

Responses to the consultation are to be received by **21 December 2023**. Subject to the outcome of the consultation, it is anticipated that reform of some nature will be introduced as part the Leasehold and Freehold Reform Bill 2023.

The term 'ground rent' is used to describe the annual payment made by a tenant to its landlord under the terms of its lease in addition to the premium paid on the grant of the lease and in addition to any service charge. Ground rents are unregulated payments and freeholders are free to use the ground rent collected as they see fit.

Ground rents have traditionally been set at a small annual sum, frequently a nominal peppercorn. However, in recent years there has been a move away from nominal ground rents, with the increasing use of an escalating ground rent to create an income stream that can be sold to an investor. An escalating ground rent may catch out a poorly advised purchaser, unaware of the potentially substantial rise in ground rent overtime, and the impact that this may have on the value of their lease. Indeed, many lenders will not finance the purchase of an existing residential lease if specified levels of 'onerous' ground rent are exceeded.

The issue of increasing ground rents has been addressed to some extent by the introduction of the Leasehold Reform (Ground Rent) Act 2022 which requires the ground rent in all new leases to be a nominal peppercorn. However, this does leave a considerable number of existing tenants paying significant ground rents under existing leases and it is these tenants that the options set out in the consultation paper are aimed at assisting, with Michael Gove announcing that he is 'immovable' in his aim to 'address these unregulated costs once and for all, protecting leaseholders and making not only the dream of home ownership, but everyday household bills, more affordable.'

Options for consultation

The five options for consultation are:

1. Cap ground rent at a peppercorn.
2. Set a maximum financial value for ground rent.
3. Cap ground rent at a percentage of the property value.
4. Limit ground rent to the original value when the lease was granted.
5. Freeze ground rents at current levels.

The consultation also asks for views on the following questions:

- What is the scope and scale of the problem for leaseholders?
- Which of the five options will deliver a 'fairer deal' for leaseholders?
- Should there be a delay before implementing any cap on ground rents?
- Are there types of lease that should be exempt from any cap on ground rents?

The options set out above relate to existing residential leases. Each of the five options would take retrospective effect to vary the commercial terms agreed between landlord and tenant at the time of the grant of the lease.

Option 1: Capping ground rent at a peppercorn is the most extreme and would see all ground rents reduced to zero regardless of the current ground rent, premium paid on grant, length of term, value of property or other agreed lease terms. This would bring all existing residential leases in line with new residential leases but would mean the most significant financial impact for freeholders. It is also surely questionable whether this option is more 'abolition' than 'cap'.

Option 2: Capping ground rent at an absolute minimum value would allow freeholders to continue to receive a ground rent subject to an upper financial value (an annual figure of £250 is suggested) regardless of the value of the property. The consultation document indicates that this option may not go far enough for government, as in capping rather than abolishing ground rent, this option would not "eliminate the anachronism of ground rents for existing leases [and] does not deliver fairness and equality between new and existing leaseholders".

Option 3: Capping ground rents at a percentage of the property value would also allow freeholders to continue to receive a ground rent subject in this case to a cap based on the value of the property (0.1% of the property value is suggested). This is an option that found favour with many of the consultees responding to the 2017 consultation and would potentially have a lower impact on freeholders whilst allowing affected leaseholders to remortgage and sell, but would require a property valuation to calculate the cap and, as with option 2, would not give existing leaseholders equality with those entering into new leases.

Option 4: Capping ground rent at the original amount it was when the lease was granted would also allow freeholders to continue to receive a ground rent at the initial agreed rate thereby, to some extent, taking into account the original terms agreed by the parties albeit that the ground rent would be capped at this sum for the rest of the lease term and any agreed provisions for review would be of no effect. However, as with options 2 and 3 this option would not give existing leaseholders equality with those entering into new leases.

Option 5: Freezing ground rent at current levels would also allow freeholders to continue to receive a ground rent, but at the higher current level where the ground rent has increased since the grant of the lease. Again, this option takes into account the original terms agreed by the parties but is likely to be unattractive to leaseholders where the ground rent is already high and would therefore "fail to provide the immediate support needed to some of the leaseholders facing the most excessive costs". In addition, and as with options 2, 3 and 4, this option would not give existing leaseholders equality with those entering into new leases.

It is notable that 'no change' is not an option on the table, and that reform of some form is seemingly inevitable.

Impact for freeholders

The impact for freeholders will vary depending on the option for reform that is implemented (if any).

It is clear from the consultation that freeholders will not be compensated for their loss of income: "Regardless of which option is taken forward, we would not expect to compensate freeholders for lost revenue, nor do we expect

freeholders would be able to capitalise this lost income stream through other means.” It may be of scant comfort to freeholders to read that the consultation does not consider it appropriate for leaseholders to be reimbursed for sums paid prior to any cap coming into force.

The consultation acknowledges the need to ensure that freeholders remain engaged in the ongoing management of properties and recognises that a ground rent income stream may, therefore in turn, provide benefits to leaseholders. However, this is countered by the statement that the receipt of a ground rent does not necessitate any obligation on the freeholder to undertake long term stewardship of a property – particularly where there is already a service charge in place.

The potential impact that the reforms may have where ground rents are held by investors, including institutional investors and pension funds is also considered, but the consultation puts forward the view that the use of escalating ground rents as an income stream is perhaps inappropriate stating “an unfortunate consequence of this investment has been a leasehold system ever more focused on generating assets at the expense of the people who own these homes.”

Once implemented any proposed cap will take retrospective effect and will apply to all existing residential leases, although there may be scope for certain lease or property types (to be identified as part of the consultation process). The consultation invites views on the benefit a delayed implementation by way of a transitional period, possibly imposing a freeze or reduction in ground rents during a transitional period if a total ban (i.e. option 1) is then implemented. A transitional period will, in the apparent absence of any compensation for freeholders, be of limited benefit, and will merely postpone the inevitable loss of revenue.

Impact for tenants

The proposed reforms will undoubtedly be welcomed by residential tenants who will potentially see a significant reduction or indeed complete abolition of the ground rent currently payable under their lease. However, whilst it is perhaps hard not to have sympathy for those leaseholders caught out by an escalating ground rent, blighting the value of their property, ground rent provisions are a key term of a residential lease and should have been considered at the time of grant or later purchase.

Consultation

Responses to the consultation are to be received by 21 December 2023. The consultation comprises 35 questions with respondees given the option of selecting an answer from the drop down menu together with additional explanation where appropriate. The consultation can be [viewed here](#).

Views will of course be divided. Clearly freeholders would prefer the contractually agreed lawful ground rent provisions in existing leases to continue to apply, and will argue that reform is not necessary. If a cap is considered necessary to protect leaseholders that find themselves paying an unduly high ground rent, out of proportion to the value of their property, a suitable compromise would perhaps be a cap of some nature giving regard to the value of the property, rather than an outright abolition in the form of the imposition of a peppercorn ground rent in all cases. Such an approach, whilst still not attractive for freeholders would give additional support and protection to those suffering hardship without providing a windfall to all residential tenants at the cost of the freeholder.

Contacts

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