

19 September 2017

Tackling unfair practices in the leasehold market

Introduction

The Royal Institution of Chartered Surveyors (RICS) is pleased to respond to the above consultation. RICS is the leading organisation of its kind in the world for professionals in property, construction, land and related environmental issues. We accredit over 118,000 professionals (FRICS, MRICS, AssocRICS and trainees) and any individual or firm registered with RICS is subject to our quality assurance.

We regulate and promote the work of these property professionals throughout 146 countries and are governed by a Royal Charter, approved by Parliament and monitored by the Privy Council, which requires us to act in the wider public interest.

Since 1868, RICS has been committed to setting and upholding the highest standards of excellence and integrity – providing impartial, authoritative advice on key issues affecting businesses and society. RICS is a regulator of both its individual members and firms enabling it to maintain the highest standards and providing the basis for unparalleled client confidence in the sector.

Consultation Responses

This consultation covers 4 distinct topics that need to be understood and addressed separately.

1. The ground rent scandal – where onerous ground rents regimes were not properly identified and considered during the transactions process
2. Considering the efficiency and usefulness of the leaseholder tenure – the tenure has existed for some time now without causing significant issues in the market and even providing a useful tenure for horizontally occupied multi story buildings. The issues arise where the leaseholder, lenders and property professionals are misled or misinformed about their obligations.
3. Understanding the impact of leaseholder tenure on housebuilding
4. Freeholder rights in relation to service charges

Before continuing, it is worth noting the difference between service charges and ground rents. Service charges exist to maintain a level of property services expected by the occupiers of a property. Ground rents cannot be justified in any way other than to provide the freeholder/beneficiary with an income stream. Although it is only recently that sale of leasehold houses have featured increased quantum ground rents, and more frequent review periods, usually to a formula, which compounds the monies passing to onerous levels.

Historically, ground rent was set at a nominal rate having little effect on property values, which were mainly impacted by the reversionary value of the lease. This was standard industry practice until recently, and valuation guidance provided to RICS members was based on the assumption that ground rents would not be onerous.

Leasehold arrangements with ground rent provides income to freeholders, also maintaining the landlord and tenant relationship. Many London Estates do not actually wish to sell freeholds, and that can apply across the sector.

Onerous ground rents, if not identified from the outset and factored into decision-making, may have a negative impact on the market without providing any benefits or services for the cost, in contrast to service charges covering the maintenance of properties.

Setting onerous ground rent charges without adequately, disclosing that information, clearly brings the industry into disrepute and introduces additional risks to lenders and buyers, and reputational damage to the vendor. It should be the responsibility of professionals in the homebuying/selling process to act with full disclosure, in the best interests of the prospective leaseholder. This applies equally to purchasers of conventional horizontally-divided leasehold property.

Question 5

What steps should the Government take to limit the sale of new build leasehold houses?

The Government should require sellers to explicitly state ground rent conditions alongside any other factors that would have an impact on price and mortgageability. If government recognizes ground rent charges as material information than this can be covered under Consumer Protection Regulations (CPR) and enforced by trading standards.

All parties need to ensure that the purchaser fully understands the implications over time of the obligation. This also needs to be recorded to protect all parties.

The house-builders' main concern is to sell the newly-constructed houses, otherwise the value of the houses sits on their balance-sheets. The ground rent is, in essence, a secondary stream of funds, but the primary purpose is to sell the house. In many ways, the market will take care of this phenomenon if prospective purchasers are properly advised at the outset, because they will make their offers without accepting the ground rents. Given that choice, the house-builder will be under pressure to reduce the ground rent rather than lose the sale.

Limiting the starting value and increase of ground rents on all new residential leases over 21 years, as detailed in the consultation document, will also contribute to limiting the marketing of new build leasehold houses.

Question 6

What reasons are there that houses should be sold as leasehold other than under the exceptions set out in paragraph 3.2?

Houses on private estates where the freehold of leased houses is vested in a freeholder utilising lease covenants to maintain standards and recharge costs on the estate as a whole.

It is worth highlighting one of the benefits of leasehold houses. That is, it makes it possible, with a lease, to contain positive covenants for the lessee to contribute towards the upkeep of the communal areas. On a freehold transfer, it is only possible to impose negative covenants. Hence why it is appropriate for horizontally occupied properties with high proportion of common parts and obligations.

Question 7

Are any of the exceptions listed in 3.2 not justified? Please explain

All exceptions listed are justified

Question 8

Would limiting the sale of new build leasehold houses affect the supply of new build homes? Please explain.

Ground rent is usually a small revenue stream for housebuilders and developers and will therefore not affect the supply of new build homes.

Additional cost, if capitalised, could be included in the land value calculation and the modelling of the s106 affordable housing quota.

Question 9

Should the Government move towards removing support for the sale of new build leasehold houses through Help to Buy Equity Loan, unless leasehold can be justified and where ground rents are reasonable (which could be a nominal or peppercorn ground rent), and if not, why not?

Agreed – Sale of new build leasehold houses through a Help to Buy Equity Loan could constitute an additional risk to lenders, banks, and public finances due to the likely accelerated depreciation, and on-sale risk.

Question 10

In what circumstances, do you consider that leasehold houses supported by Help to Buy Equity Loan could be justified?

The conventional leasehold model is tried and tested tenure for horizontally occupied properties with high proportion of common parts and obligations.

As stated before, the issue is with onerous ground rents and a lack of awareness of the rights and obligations with the leasehold tenure. Where any costs are incurred in maintenance and upkeep, s20 of the 2004 Housing Act (regulation of multi-occupied properties i.e. service charges) already provides a regulatory framework which ensures tenant rights and protections.

Leasehold regime is distinct from the ground rent scandal, by which we refer to leasehold homes with onerous review clauses, and should not be conflated.

Leasehold tenure however, is justifiable on schemes such as apartment blocks, CLTs, Co-ops, co-housing and the like alongside the exceptions listed in this paper.

We would advocate the production and adoption of a housebuyers code of agents' best practice, incorporating a customers' charter setting out in principles the level of service a purchaser can expect, and flagging up risks in the conveyancing process. RICS already have advice for purchasers located in a variety of sources which we suggest is worked up into an industry code of practice.

Question 11

Is there anything further the Government could do through Help to Buy Equity Loan to discourage the sale of leasehold houses?

The Government should consider banning the sale of leasehold houses with onerous review clauses through Help to Buy Equity Loan on the grounds of future sales risk of the property.

Question 12

What measures, if any, should be considered to minimise the impact on the pipeline of existing developments?

An outright ban or clear controls on ground rent will level the playing field, with developers competing on equal terms for purchasing land.

We must reiterate that that leasehold tenure is not the concern here but the onerous ground rents that can come with them.

The Government should consult with the house-selling industry to justify any ground rent benefit to the leaseholder.

Question 13

What information can you provide on the prevalence of onerous ground rents? We are keen to receive information on the number and type of onerous ground rents (i.e. doubling, or other methods) and whether new leases are still being sold with such terms.

We do not hold this data

Question 14

What would a reasonable ground rent look like, in terms of i) the initial annual ground rent, ii) the maximum rate of increase in annual ground rent, and iii) how often the rate of increase could be applied to an annual ground rent? Please explain your reasons.

Ground rents can be justified only if they are transparent and well understood by the buyer and lender, who can calculate its long-term costs to inform their initial offer.

Question 15

Should exemptions apply to Right to Buy, shared ownership or other leases? If so, please explain.

No exemptions should be applied, unless vested in a scheme to deliver additional affordable housing

Question 16

Would restrictions on ground rent levels affect the supply of new build homes? Please explain.

See Q8 response

Question 17

How could the Government support existing leaseholders with onerous ground rents?

There must have been full disclosure before the point of purchase and protection to the consumer given by compliance with the Consumer Protection Regulations with the seller being liable if there is a case of mis-selling in terms of leasehold. There are suggestions that the information was intentionally fragmented and obfuscated, in which case in which case there needs to be a review of what has happened and a redress process should be available for those affected by any mis-selling. Key criteria are around the effect of the ground rent covenants on the purchaser's ability to buy, sell or remortgage.

If the ground rent is so onerous that the purchaser is unable to sell the property or remortgage, the Government should consider applying sanctions that protect the purchaser from potential eviction.

Question 18

In addition to legislation what voluntary routes might exist for tackling ground rents in new leases?

Full disclosure and best practice with regard to fairness to the consumer. The Law Society's LPE1 and LPE2 forms are currently light on their coverage of ground rent. For example, the review period and uplift mechanism is not included.

Question 19

Should the Government amend the Housing Act 1988 (as amended by the Housing Act 1996) to ensure a leaseholder paying annual ground rent over £1,000 in London or over £250 in the rest of England is not classed as an assured tenant, and therefore cannot be issued with a Ground 8 mandatory possession order for ground rent arrears? If not, why not?

Agreed – however annual ground rent over £1,000 in London or over £250 in the rest of England is high and needs to be justified. The Government should consider a lower figure. The disparity between London and the rest of England is also too wide.

Q20: Should the Government promote solutions to provide freeholders equivalent rights to leaseholders to challenge the reasonableness of service charges for the maintenance of communal areas and facilities on a private estate? If not, what management arrangements on private estates should not apply?

Yes - subject to a simple and efficient consultation process. Government should consider capping unduly restrictive covenants, especially which give rise to egregious event fees e.g. for extensions, conservatories, internal alterations etc. and applying a 'reasonableness' criteria to estate fees for freeholders.

Government should consult with the Competition and Markets Authority to arrive at a reasonable cap.

Q21: The Housing White Paper highlights that the Government will consult on a range of measures to tackle abuse of leasehold. What further areas of leasehold reform should be prioritised and why?

Government should impose mandatory regulations on property managers to be trained and qualified through a professional body. This would ensure existing standards and regulations are upheld and provide a means for the sector to regulate itself.

We look forward to seeing the results of the consultation and if we can be of any further assistance, please do not hesitate to get in touch.

Yours sincerely,

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