

# **A response by Ground Rents Income Fund plc to the consultation on *Tackling unfair practices in the leasehold market***

## **OUR POSITION**

Ground Rents Income Fund plc<sup>1</sup> (GRIF) welcomes this consultation. We recognise that in some cases homeowners have faced onerous ground rent terms. Therefore, it is quite right that Government and industry should work together to improve the leasehold system for all in the future. While there have been instances of poor practice, particularly focusing on 10-year perpetually-doubling rents<sup>2</sup>, there is a continuing need for both the leasehold system and ground rents because where reasonable and transparent terms are in place, homeowners genuinely benefit. Reasonable rents create an incentive to attract engaged investors and landlords, like GRIF; and we strongly believe our growing involvement in this service is to leaseholders' advantage because we invest for the long-term and we take our responsibilities to protect leaseholders' most precious assets seriously.

## **EXECUTIVE SUMMARY**

GRIF has purchased the freehold or long-leasehold of around 18,000 properties nationwide. Brooks Macdonald Funds Limited, which acts as the Alternative Investment Fund Manager to GRIF, discharges its discretionary management responsibility for GRIF's portfolio, which includes advising on new investment opportunities and maintaining the good condition of the current properties under GRIF freehold or long leasehold ownership. This is done in part through Braemar Estates, a sister company in the Brooks Macdonald Group which directly manages approximately 14% of the leasehold properties within the GRIF portfolio; and provides oversight, expertise and monitoring support to those properties which are managed by leaseholder controlled Residents' Management Companies.

We are a responsible landlord and investor, and like other engaged landlords and institutional investors, we want to see a sustainable long-term leasehold market. Our shareholders are pension fund managers and long-term savings investors. In most cases, the leases we own are exceeding 150 years, a length commonly regarded as a long lease, and the ground rent is linked to RPI increases or less. GRIF mainly acquires pre-existing freehold and long leasehold contracts on a secondary basis; by this point, the terms and duration of the lease are set.

Our mean annual ground rent charge is £179 for houses and £234 for apartments. 84% of the 18,000 properties are ground rents where there is no increase, an RPI increase or a fixed increase less than the expected RPI rate. 16% of the remainder are doubling rents, but the vast majority of these have rents that double over prolonged periods meaning that they reflect the expected rate of RPI or they are lower than that. 4% of our leaseholders, spread over three developments only, do face ground rents that double every ten years on three occasions (before then tracking RPI or remaining flat). We have publicly stated that we will be writing to the minority of our leaseholders who have doubling rents to offer them the lesser of doubling rents or rises in line with RPI. We expect that this will benefit the 4% we have identified.

Because we are an involved landlord, we are therefore pleased the Government has published this consultation because we need a system that delivers a more equitable, transparent and better service

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<sup>1</sup> More information on GRIF is at the end of the document on page 14

<sup>2</sup> "The ground rent scandal that is engulfing new home buyers"; The Guardian, 5.11.16

for homeowners. To do this, we need to regulate freehold ownership and the management of leasehold properties. We recommend the following actions:

- Prospective homebuyers should not be offered a leasehold house when there is no overriding reason the house should not be sold under freehold ownership.
- There should be limits to what freehold owners can charge in ground rents, including a probation on onerous rent review provisions, with respect to newly-granted leases.
- We believe that such long leases like those we own, or indeed longer, should be the model term. Long leases like these are generally accepted to be similar in value to the equivalent freehold property.
- A code of conduct which safeguards the rights of leaseholders, including an ombudsman with teeth, should be established. In addition to clearly setting out the rights of the leaseholder, it would make clear all the responsibilities, obligations and competencies that the freehold owner and managing agent would have to perform and work to. Developed with industry input, we recommend that Government or the appropriate public agency should 'own' and be able to enforce the code.
- We have received examples of our leaseholders telling us that they were unaware of the provisions contained in their leases. This points to leaseholders receiving inadequate legal advice at the purchase point.
- We would address this by requiring relevant contractual information to be in plain English, standardised – and like purchasing a financial product – there must be clearly worked examples about how ground rent charges could change over time. This should be extended to maintenance charges and any sinking fund provision.
- In addition, a buyer's legal advisers like a solicitor must be fully independent of the developer. Given the importance of the purchase, it should not be acceptable for buyers to be offered advice by a person or firm employed by or on the legal panel of another interested party.

We believe that targeted solutions such as these are necessary and will deliver the greatest benefit to leaseholders. We must resist calls for wide-ranging prohibitions to charging ground rent. Reasonable ground rent creates an alignment between landlord and leaseholder; providing the economic incentive for involved investors and landlords to take responsibility for the safety and upkeep of shared assets such as; walls, roads, lifts, stairwells, safety systems, the outer skin of the building such as the cladding, communal areas, and community heating systems. Indeed, some residents choose leasehold ownership because it provides confidence in the fact that the appearance of their area will be maintained. It is also the case that Residents' Management Companies have become more aware of their legal health and safety responsibilities in the last few months, and so having that supporting expertise and a body that is ultimately responsible for ensuring a building's maintenance has become more important.

Ensuring that the value of homeowners' most precious assets is maintained does cost money. Some stakeholders like Nationwide have suggested that 0.1% of the property's value is a suitable maximum limit for annual ground rent charges. We disagree. The average house price in the UK is £223,257<sup>3</sup>, meaning in effect a 0.1% yearly ground rent cap of £223. This is pretty much in line or more than the average amounts we charge leaseholders (noted on page one). However, this does not fit where the value of the property is well below the UK average. For that reason, we suggest a 0.3% cap. This isn't to say that our suggested limit is commonly applied. Indeed, our average annual apartment and house ground rent charges as a proportion of the estimated recent sales prices of the properties are in the order of 0.12% and 0.11% respectively. But we do need to support higher rent-to-house value ratios where this is justified in paying for a valuable service. Indeed, to ensure a professional freehold service,

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<sup>3</sup> UK House Price Index, August 2017

irrespective of location, there is a case for a minimum ground rent benchmark where shared assets and services exist.

We do need to be aware of the creation of unintended consequences. A widespread restriction of ground rents would impact on the supply of new homes. Regional and national developers, as well as specialist property advisers, report to us that outside London and the South-East especially, the sum paid by freehold investors to developers to acquire the freehold of a housing development has a material effect on whether projects are viable. While the market could recalibrate over time, working back to lower land values, withdrawing ground rents would impact on the 2-3 year forward plans of developers where land has been earmarked, valued, bought or building work is ready to commence.

Additionally, while accepting that long leases are generally priced on a par with freehold equivalents, introducing a widespread ban on ground rents for newly granted leases could actually serve to negatively impact on existing leaseholders. If there will be less leasehold houses on the market as a proportion – and this happens very suddenly and on a blanket basis – this may be priced into existing leasehold property sales, where somebody is trying to extend their lease or where seeking to buy the freehold to an existing lease.

For these reasons, we want to work with Government to create a regulatory framework which navigates these potential unintended consequences, but provides the rigour and confidence to support a ground rent sector that genuinely works in the interests of leaseholders.

**Q1. (What) are you responding as:**

An organisation.

**Q2. If you are responding as a private individual, (what) is your main interest:**

NA.

**Q3. If you are responding on behalf of an organisation, (what) is the interest of your organisation:**

An investment company that has a portfolio of ground rents.

**Q4. Please enter the first part of your postcode**

W1G.

**Q5. What steps should the Government take to limit the sale of new-build leasehold houses?**

Where there is a freehold site, either green or brownfield, and a developer is selling houses that do not share assets or services with others in that development or road, we in most cases believe that there is no reason that they should only be offered to prospective buyers as leasehold properties.

Before offering our recommendations for limiting the sale of leasehold houses on these terms, there are several points to consider.

More shared assets and services

Industry and Government are keen to pursue modular, simpler construction methods to keep costs down, provide higher environmental standards and ensure more affordable homes for more people.

More homes will in the future benefit from common energy systems, such as district heating networks. Homes in the future could be more compact. This will mean that more homes are built, some of these being houses, which have shared services and infrastructure. In practical terms, the long-term oversight of the maintenance of communal estate areas and energy infrastructure can best be provided by the leasehold system, as opposed to commonhold where the management and liabilities would entirely be a matter for the residents. We must be careful not to stifle innovative land, time and cost-efficient development concepts (like the Capital & Centric Nowhaus concept) by wholesale reform to the present leasehold system.

#### Ensuring the value of the homeowner's property is not diminished

It is important to note that having obligations that shared services and areas (gardens, play areas, unadopted roads) are managed and maintained and that people treat their home in a way that respects their neighbours, are important benefits of the leasehold system.

An example of a residents' covenant could be that in many housing estates, it is formally written into leases that boats, caravans and commercial vehicles cannot be stored on site, given that many consider these items to diminish visual amenity and 'lower the tone of a development'. The lease and covenant provide the means to manage the area for the benefit of all residents, ensuring the continuation of a highly-regarded common environment. Therefore, many purchasers take genuine comfort from lease terms such as this. Indeed, some may buy in a certain location for the reason that the lease provides genuine protection for their most precious asset, which they would and should fully expect the landlord or freeholder to enforce.

Conversely, where it is often viewed that leasehold properties have onerous conditions, such as restrictions on sub-letting and alterations, it is not always the case that the covenants on freeholders are any less intrusive.

#### The availability of the freehold

In many instances, the freehold of sites is not available for developers to offer new homeowners. We are aware of many instances where the developer buys long leasehold development sites of say 250-999 years, because the freehold of the sites is simply not for sale.

This is often because the landowner cares about how the area will evolve; because they have adjacent land or they have a societal interest. As identified in 3.2 of the consultation document, there are some large-scale freeholders who often take this view. They include; Crown Estate, National Trust, local authorities, Government agencies, the Church of England and a range of charities.

Such bodies often want to retain an element of control through retention of their freehold estate. This can be an important factor in developments going ahead.

#### Limiting the unjustified sale of leasehold homes

We would be pleased to work with Government to find a way that legislation can limit the sale of leasehold homes where there are no adequate grounds for it not being sold as a freehold property. This may be complex, however, and we believe that there are other easier and quicker measures which the Government should first look at to achieve its aims.

The complexity in creating or amending legislation is not solely down to enabling flexibility depending where there may be a need to offer leasehold terms; in addition, any legal definition must also clarify

the complication of what constitutes a house in law. Legal definitions need to be clear and unambiguous. GRIF, for example, purchased the ground rent interest of a development in West London which was a combination of apartments and townhouses. The site is made up of what many would think were houses, but as they are above an underground car park, the law states that they are not houses.

Rather, the Government and UK Finance (formerly the Council of Mortgage Lenders) should offer guidance to UK Finance members as to what constitutes as reasonable criteria for developers to offer leaseholds to prospective buyers (noting any exemptions). Developers would not offer what they could not sell.

Alongside this, we recommend that regulating the sale process of all properties would be a good first step. We advocate reforming the information provided to leaseholders about the terms of their lease. A buyer's legal advisers like the solicitor must be fully independent of the developer. (We cover this more in our response to question 21).

**Q6. What reasons are there that houses should be sold as leasehold other than under the exceptions set out in paragraph 3.2?**

As we have set out in our response to question 5, where there are shared services, assets and obligations that require oversight, management and maintenance by a responsible freeholder and agent, new build houses should still be capable of being offered on leasehold terms.

Even where a Right to Manage or Residents' Management Company (RMC) is in place and has commissioned a managing agent, residents need help from a highly professional body working on their behalf. This is particularly the case, for example, when it comes to maintaining a complex energy system, or ensuring compliance with legal requirements. The number of residents interested in sitting on an RMC has also fallen in the wake of the Grenfell Tower tragedy. In the period since the fire, and with the realisation that Directors cannot be indemnified from criminal health and safety failures, we understand that Braemar Estates, along with other managing agents, have received a higher number of resignations than usual from Directors of RMCs.

GRIF, like other engaged landlords, believes that our growing involvement in responsible freehold investment offers a really valuable backbone in providing expertise, monitoring when reviews need to happen, and ultimately assuming responsibility for the ongoing protection of leaseholders' properties. Braemar Estates, for example, has a detailed management system that tracks the status of every property under its management in GRIF's portfolio to ensure (insurance, fire, health and safety) documentation is up to date; as well as flagging, for example, when inspections covering the safety and performance of buildings need to be commissioned.

The important reality is that to take on the ongoing oversight and responsibility, there needs to be an appropriate economic incentive to attract the long-term participation of engaged landlords and investors. It is because we view our involvement as long-term that we want to see a more regulated leasehold and ground rents system. This should involve price limits or guides as to what rent can be charged for new leases (and perhaps minimum levels so that the oversight role can be properly discharged); limitations on rent review provisions; and importantly, stronger requirements on the managing agents and services that they and freehold owners provide and oversee. To this end, we recommend a Government-owned code of conduct, which we elaborate on in later answers.

We also recommend that leasehold houses should continue to be offered for mixed-use developments where there are broader land use and management issues. This is because offering leaseholds and a

greater measure of control through the covenant on homeowners may be appropriate in balancing all stakeholder interests.

GRIF is negotiating the purchase of the head lease of a large mixed-use site in Kent, where the scheme has various elements, including build-to-sell residential, social and affordable housing, office, leisure and retail. The scheme is delivering key public services and creating jobs in the local community. The local authority has retained ultimate freehold ownership, and are deriving income from it for the duration of the head lease term.

**Q7. Are any of the exceptions listed in 3:2 not justified?**

There is an argument that local authorities (and perhaps other public landowning bodies) should be able to retain the freehold to the development, but only in certain conditions.

Councils, in particular, may want to retain an element of control as to how an area develops, particularly if it is a site earmarked for regeneration purposes. If this supports more development and public land becoming available, then there may be a good reason for it. We have witnessed many examples of public private partnerships which have only been viable in terms of delivery because of the involvement of the local authority.

Ultimately however, we do not consider that so many public bodies and charities should be subject to special exemptions. And any exemptions provided should also be for narrower reasons. Individual covenants and/or planning conditions may be enough to give councils a measure of control on what can and cannot be done.

**Q8. Would limiting the sale of new build leasehold houses affect the supply of new build homes? Please explain**

While our overarching position is that leasehold houses should not be offered where there is no good justification, we do think that it is right to caution against a significant limitation or abolition on leasehold houses offered.

Developers, from volume house builders to smaller, regional developers (particularly those appealing to the more affordable, less affluent end of the market) have reported to us that action of this kind could affect the supply of new developments. This is because revenue from ground rent sales has become a meaningful part of the housebuilder's gross development value over the past 10 years. In particular, developers state that those developments largely in lower cost and economically less affluent areas of the country, or which are quasi-residential (hostels, co-living), would simply not be viable without the ground rent capital sum contributing towards the profitability of a scheme.

Indeed, this view is also borne out by several specialist property agents that we have spoken to. They argue that with most developers planning on a 2-3 year cycle, a sharp limitation of ground rents (or indeed if any ground rent maximum cap is too tight) for new leasehold houses will curtail some developments within this period, particularly those in areas of the country where property prices are lower than the average. One agent estimates that without the ability of the developer to factor in a reasonable ground rent sum for both new houses and flats, several hundred developments in planning may be affected.

It could be argued that limiting the sale of new build leasehold houses in this way would ultimately lead back into lower land values. This may be so. However, there would be a lag that could genuinely stall some developments coming forward and those in planning.

Additionally, while accepting that long leases are generally priced on a par with freehold equivalents, introducing a widespread ban on ground rents for newly granted leases could actually serve to negatively impact on existing leaseholders. If there will be less leasehold houses on the market as a proportion – and this happens very suddenly and on a blanket basis – this may be priced into existing leasehold property sales, where somebody is trying to extend their lease or where seeking to buy the freehold to an existing lease.

**Q9. Should the Government move towards removing support for the sale of new build leasehold houses through Help to Buy Equity Loan (HTB), 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?**

Yes. This seems like a sensible way forward where no oversight and maintenance of shared assets and services is required.

Moreover, we suggest that Help to Buy is an important lever in influencing many large volume developers. The Government may want to use this to encourage those housebuilders to only offer leasehold houses where there is justification (flowing from Government guidance). This may be an alternative to legislation if this proposal could take effect more quickly and offer a less complex solution. (We expand upon this in other answers).

**Q10. In what circumstances do you consider that leasehold houses supported by HTB could be justified?**

As part of a wider community scheme, where ground rents and meaningful covenants are required to bind all the stakeholders together.

**Q11. Is there anything further the Government could do through HTB to discourage the sale of leasehold houses? Please explain**

We have noted the importance of Help to Buy to the large volume housebuilders. Utilising that leverage to discourage the inappropriate marketing of houses as leasehold would be a good way forward.

In conjunction with UK Finance, the offering of leases for properties with no justification or the offering of leases adjudged not equitable could be quickly stopped by the development of guidance around the availability of mortgage finance.

The co-development of guidance by Government and UK Finance would be the simplest and quickest path of least resistance to making the industry regulate itself. The guidance would need to be considered. Nationwide Building Society issued a statement earlier this year in which it said that it was unwilling to offer mortgages on new build properties which had a ground rent greater than 0.1% of the capital value. We cover our concerns around this figure in other answers, should this become a wider benchmark.

Additionally, for mortgages offered through Help to Buy, the purchaser should not be offered legal advice that is linked to any interested party, such as the developer or estate agent. It is more likely that fully independent advice will clearly flag the existence and meaning of ground rents and maintenance charges to prospective buyers. We think that this should be a requirement across the

board, like that required for offering financial advice. But utilising the Help to Buy scheme would be a trial or initial way to roll out good practice.

**Q12. What measures, if any, should be considered to minimise the impact on the pipeline of existing developments?**

There is a suite of changes with clear outputs that could be taken to improve transparency, performance and stop disproportionate pricing that could be implemented quickly and would not impact on the pipeline of existing developments. As noted in response to question 8, a significant restriction beyond that we are suggesting for leasehold houses, which also included limitations on leasehold flats, would affect new developments in the pipeline.

As noted in our answer to question 11, for newly granted leases, UK Finance could clarify and simplify their minimum property requirements (e.g. minimum length of lease term and maximum level of ground rent/acceptable rent review provisions) to limit the sale of leasehold homes without justification, as well as ground rents above a certain amount. Developers would not build a product which was not mortgageable. On newly-granted leases, a sensible starting ground rent of less than 0.3% of the purchase price could be quickly instituted. (We explain the reason behind this figure in answer to question 14). We believe that limitations below this amount would unduly restrict new developments, particularly in areas of the country where property prices are below the UK average. Indeed, as we mention elsewhere, to ensure a professional freehold oversight and managing agent services, irrespective of the leaseholder's property purchase price, there is an argument to look at minimum ground rent levels.

Supporting this, we and other landlords and investors in the industry such as Long Harbour are at an early stage of exploring a robust code of conduct governing ground rent charges, the behaviour of the freehold investor and the management service provided. This is because regulation in this area is largely absent; and we recognise that self-regulation in the market on its own is not sufficient. While involved landlords like ourselves would welcome the opportunity to work with Government on the development of the code, we are clear that the code should be owned and enforced by Government. We set this approach out in more detail in our response to question 18.

The code of conduct could better incorporate making the section 5 Right of First Refusal pre-emption process more leaseholder friendly and robust. This would give consumers more protection and the opportunity to own the freehold of their own home or development. Presently, the process is complex and hard to understand for a lay person and there are also ways to circumvent the process.

As noted earlier, other supportive actions should be taken, such as the provision of more independent legal advice, with better information offered on charges like for financial products.

**Q13. 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 on such terms.**

GRIF's mean and median annual ground rent charges for an apartment are £234 and £250 respectively; and its mean and median annual ground rents for a house are £179 and £110 respectively. Ground rent for the houses in our portfolio is lower than apartments due to owning the freehold on 1,008 houses in the North-West (where there is a median ground rent of £75). As the consultation notes, many houses in the North-West have historically been sold as leasehold in the region (43% of all properties in Manchester are leasehold, compared to 15% in England and Wales<sup>4</sup>).

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<sup>4</sup> MyHomeMove

The total GRIF portfolio as of 2 August 2017 consists of:

Type of rent review	% of income
Index-linked (mainly with RPI)	69.8
Flat (no cost increase)	6.5
Fixed uplift <sup>5</sup>	7.3
Doubling (10 years)	4.0
Doubling (25 years)	10.0
Doubling (33 years)	0.4
Doubling (35 years)	0.2
Doubling (50 years)	1.8

15% of the total portfolio are houses, which generate 11% of total ground rent income. Looking at the ground rent on our leasehold house units, they consist of:

Type of rent review	% of income
Index-linked (mainly with RPI)	66.7
Flat (no cost increase)	27.0
Fixed uplift	3.6
Doubling (25 years)	2.7

In September 2017, GRIF committed to writing to all leaseholders facing doubling ground rents to offer them the lesser of RPI or the doubling. This will in particular benefit the 4% of leaseholders facing a 10-year doubling. It should be noted this 4% only relates to three developments in which we have an interest. To clarify further, these leases do not provide a ground rent that doubles perpetually every 10 years; rather they double three times and then either track RPI or remain flat.

It should be noted that a ground rent that doubles every 25 years is effectively a year-on-year increase of 2.8%, which matches the year-on-year increase of RPI over the past 25 years. The practice of offering new leases with high frequency doubling ground rents, however, should be curtailed. As we have shown from GRIF's portfolio, these make up only a small proportion of the freeholds and long leaseholds in which we have invested.

We are a long-term investor. Our aim is to provide a professional service for a reasonable amount that is sustainable to the leaseholder. We believe that our charging approach supports this.

**Q14. What would a reasonable ground rent look like in terms of i) the initial 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?**

GRIF's mean and median annual ground rent charges for an apartment are £234 and £250 respectively; and its mean and median annual ground rents for a house are £179 and £110 respectively. As we noted, these 'house' figures are brought down by our freehold ownership of around 1,000 properties in the North-West where the median rent is £75.

<sup>5</sup> A fixed uplift adds the same fixed monetary sum to the overall amount on each review occasion; so it is effectively less than the rate of RPI as the rise gets smaller as a percentage as time goes on.

## The case for reasonable ground rents

These levels of annual ground rent charge are in our opinion not disproportionate to the value of leaseholders' properties. Our average annual apartment and house ground rent charges as a proportion of the value of estimated recent sales prices of our portfolio properties are 0.12% and 0.11% respectively.

Reasonable ground rents provide an economic incentive for engaged landlords to assume oversight, provide expertise and take on responsibility for fulfilment of the safety and upkeep of shared assets such as; walls, roads, lifts, stairwells, safety systems, the outer of the building, communal areas, and community heating systems. This, among other things, enables the development and active maintenance of Braemar Estate's system for monitoring and tracking the documentation, compliance records and inspections due for all the properties for which GRIF has an interest.

This means that our long-term investment not only helps ensure that the value of homeowners' most precious assets is maintained; but that we can provide the expertise and attention to ongoing compliance needed to safely manage housing developments.

### What is reasonable?

We do however support setting out the parameters of what a reasonable ground rent would look like. This needs consideration so as to provide a balance between finding an affordable and justifiable level of rent and ensuring that it is enough to adequately enable the delivery of a professional management role.

Owing to the need to find this balance, we were concerned by Nationwide Building Society's issuing of a statement earlier this year in which it said that it was unwilling to offer mortgages on new build properties which had a ground rent greater than 0.1% of the capital value.

We think that this limit is not an appropriate limit. The average house price in the UK is £223,257<sup>6</sup>, meaning in effect a 0.1% yearly ground rent cap of £223. This is pretty much in line or more than the annual amounts we charge leaseholders. However, if the property is valued at half that, as many are, a 0.1% could leave too little to provide a quality freehold service. So, in the case that a property is valued at £100,000, 0.3% is a more appropriate limit. On this basis, there is a good argument to suggest that a minimum level of ground rent should be established to ensure a responsible oversight service, irrespective of UK location.

In terms of a maximum limit that can be levied, we recommend that 0.3% is the nationally-applied limit. We do not think that this will lead to a broad increase in ground rents. Currently – with no limitation in place – GRIF's average charges are 0.12% and 0.11% of the value of apartment and house prices within our portfolio.

The rent should then be linked to RPI to hedge against inflation. In linking any rises to the lesser of RPI or a doubling over a long-term period, such as 25 years, it means that what leaseholders pay the freeholder will be less than the growth in their house value over time (looking at historic house price growth). Additionally, long leases should be the model offered similar or greater than the pre-existing contracts that we acquire (more than 150 years).

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<sup>6</sup> UK House Price Index, August 2017

**Q15. Should exemptions apply to Right to Buy, shared ownership or other leases? If so, please explain.**

No.

**Q16. Would restrictions on Ground Rent levels affect the supply of new homes? Please explain.**

Housebuilders of varying sizes report to us that freehold investors provide important extra funding which developers at times need in order to make developments viable, particularly outside London and the South-East. Any widespread restrictions to ground rent charges would cut off this funding, and while land values may adjust over time, there is likely to be a lag as the market recalibrates.

A leading specialist property agent that we spoke to believes that the aforementioned and mooted 0.1% limit would leave some developments with a shortfall of planned revenue which would affect their viability, as a professional landlord would really struggle to develop a working service from its output where property prices are lower than average UK price (particularly where by a margin). Hence, funding to the developer will be constricted. They cite one example – a proposed 69 unit development in Ilkeston, Derbyshire (where property prices range from £72,000-£89,000) – as a case in point. The build programme is 12 months and reservations are being taken. The starting annual ground rent is £250 with any rises in line with RPI. This has been explained to the prospective homebuyers. A 0.1% limit would of course bring down the rent to no more than £90 per year.

We do however believe that a balance exists between providing for reasonable ground rents and not impacting the supply of new homes.

As we have stated, this is not the only reason to retain an appropriate level of ground rent being charged. It provides an economic incentive which enables the active engagement of responsible investors who now make up the majority of this £350m<sup>7</sup> market, as opposed to disengaged landlords, some of whom have traditionally been private individuals. It is our view that institutional investors can best provide the professional oversight and management of properties as a part of a transparent, well-regulated freehold investment and managing agent market.

**Q17. How could the Government support existing leaseholders with onerous ground rents?**

Government should not attempt to unwind existing leases to support current leaseholders with onerous assets. House purchases have been made and signed. In doing so, homeowners will have importantly had access to legal expertise. The issue here is that in some cases, leaseholders have purchased a property without being fully aware of their leasehold obligations. This can in the future be best alleviated by requiring clearer, standardised contractual documentation, worked projections, with an additional requirement for independent legal and financial advice. These are perhaps the most important set of reforms that should be made.

GRIF has made a decision to offer its existing leaseholders on doubling grounds rents the lesser of RPI or the doubling. For 4% of the leaseholders under GRIF's portfolio who are on 10-year doubling rent increases, the RPI option is likely to be preferable. (It should be noted that these 10-year doubling rents do so only three times, not perpetually). However, based on historic rates of RPI, a doubling of ground rent at 25 years actually works out similar to pegging to annual increases in RPI, but without the volatility risk of inflation. We would argue this is not onerous given the level of house price rises (looking at historic rises) a leaseholder will benefit from compared to RPI.

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<sup>7</sup> Savills, 2016; measuring the volume of annual transactions

**Q18. In addition to legislation what voluntary routes might exist for tackling ground rents in new leases?**

We and other landlords and institutional investors in the industry (such as Long Harbour) are at the early stages of exploring a robust code of conduct governing ground rent charges, the behaviour of the freehold investor and the management service provided.

Reasonable ground rents should continue because they provide the incentive to deliver an important service to leaseholders. But regulation in this area is largely absent. For example, managing agents can collect and hold tens of millions of pounds of leaseholder funds, but they face no specific regulatory requirements beyond the holding of monies in a trust account.

All of this means that confidence has understandably diminished surrounding ground rent charges. Self-regulation is not wholly sufficient in providing this confidence. While engaged landlords and investors like GRIF would welcome the opportunity to work with Government on how a code would look, it would only be respected if the code was owned by a relevant part of Government; and if it had an independent ombudsman to police it.

While we are at the early stages of exploring the concept of a code, we offer below our initial thinking as some of the areas we think that a code could encompass:

- General freeholder commitment to improve and simplify processes such as Right to Manage and Right of First Refusal.
- Commitment of freehold investors and appointed freehold managers or agents to act fairly, as a sample including:
  - Employing suitably qualified staff.
  - Compliance with current and future legal obligations.
  - A duty to protect members of the public.
  - Assisting any disputes or disciplinary investigations.
  - Refrain from any act of harassment or illegal eviction.
  - Broad commitment to best practice behaviour towards leaseholder.
- Freehold investment parameters, some but not all could include:
  - Commitment to not acquiring leases that do not conform to agreed parameters.
  - Clear and equitable obligations and rights for both the leaseholder and freeholder.
  - Right for the freeholder to step in and take control in the event of a serious default by the Residents' Management Company.
  - Disclosure obligations to leaseholder around costs (insurance, accounts, sinking funds, fire risk assessment).
- Freehold management parameters, some but not all could include:
  - Adopt plain English and jargon-free charter.
  - Publish fees on website, with explanation of fees.
  - Ensure all fees are reasonable and proportionate.
  - Have a clear complaints procedure.
  - Prompt response to leaseholder communications.
  - Recognise residents' associations.
  - Have in place risk management processes and plans.
  - Provide regular health and safety and fire risk assessment to freeholder.
  - Commission external audit of performance and processes.

- Disciplinary powers
  - The Secretary of State has the power to approve a code of conduct and to enforce breaches.
  - The code can include mandatory and best practice principles.

As noted, we would welcome the chance to discuss our very initial thinking in greater detail.

Alongside this, we would recommend that Government work with UK Finance to develop guidance for lenders offering mortgages and based on minimum property requirements (e.g. minimum term of lease or maximum ground rent reserved/acceptable rent review provisions)

Another route would be the adoption of 'Responsible Developer' criteria by the House Builders Federation. We note that the HBF is looking at establishing a wider industry code, which this could fit into. In so doing, members of the HBF might sign up to agreed principles of ground rent / lease construction on only equitable principles. As we noted earlier, the role of Help to Buy provides Government with added leverage.

**Q19. Should the Government amend the Housing Act 1988 to ensure a leaseholder paying annual ground rent over £1000 in London and £250 elsewhere 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?**

Yes. It cannot be right that a leaseholder can lose their property under such circumstances.

**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 [sic] apply?**

Yes. We support granting freeholders on private estates equivalent rights to challenge the shortcomings in management expertise that can often be displayed by Residents' Management Companies and their managing agents. In the case of poorly performing RMCs, there are often 'step-in' provisions in many leases, but these are often complex and inadequate.

**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?**

The Government should licence or even legislate for residential managing agents. Other than a requirement to hold money on trust in a client monies account, statutory oversight is limited. Our suggestion for a code of conduct would be a good first step.

Reform of the Right to Manage process should be considered. In the short term, the aforementioned code of conduct idea could include such provisions, but more widely, Government should look at ways to reduce complexity and eliminate manipulation. The code could also require reasonable sums to be charged where leaseholder requests demand additional leaseholder work (from the issuing of letters to appointing a surveyor to review a major piece of work a leaseholder wants to do).

It should be noted that if leasehold provisions are being reviewed, then the legislation covering freehold house covenants should be looked at to ensure that anybody that benefits from shared

services on an estate pays for them. The current approach to binding in all house-owners is inadequate (such as not easily extending to where a freehold house is sold on to the next homeowner).

The legislation around enfranchisement might be reviewed. It is currently a complicated process as the parties try to ascertain and agree on the cost of a homeowner buying the freehold. Following consultation with industry, could a standard assessment approach be developed?

Some of the concern is around people, particularly first-time buyers, acquiring properties who are perhaps unaware of what being a leaseholder in a certain development or road entails. As a first step, developers should not be able to offer financial incentives (discounts) or other incentives (such as white goods) to buyers to acquire a property on a leasehold basis rather than the freehold. Like the Government's regulation to require independent financial advisers several years ago, there should also be a requirement for fully independent legal and financial advice when buying a property, not advice paid for, recommended or instructed by the developer (or estate agent).

As with financial products, there should be a requirement on developers to offer worked projections for a property's ground rent. This should include any maintenance charge and ground rent, again to aid full transparency at the point of purchase. The Law Society standard documentation should always be used, with clear plain English explanations (such as is required for other financial products).

Last, reform of the First-Tier Tribunal (FTT) process. Originally this was designed as a no-fault, low cost dispute arbitration process, but it has become too focused on seeking clarification on the minutest point of residential leasehold law when the subject matter is often far more fundamental. It needs to become less judicial and much more arbitral with greater flexibility. It should also be reformed to be the single avenue to deal with all residential leasehold disputes, instead of potentially the FTT, the county court and the magistrate's court. To do this, the FTT needs to be able to make declarations as to the interpretation of the lease. This would be more efficient and prevent claims running concurrently as sometimes is the case. The role of the FTT could also be widened so that it can review and rule on applications to vary the leases of houses, as well as flats.

## **About GRIF**

Grounds Rent Income Fund plc (GRIF) is a closed ended real estate investment trust (REIT) incorporated in England and Wales in April 2012. Since being launched, GRIF has acquired ground rents having an open market capital value of £143m as at 31 March 2017. GRIF was admitted to the Official List of the CISX and to trading on the SETSqx platform of the London Stock Exchange in August 2012. As a publicly listed company GRIF meets all of the UK's shareholder disclosure requirements.

GRIF has appointed Brooks Macdonald Funds (BMF) as Alternative Investment Fund Manager, an activity which is regulated by the Financial Conduct Authority (FCA) and governed by the EU's Alternative Investment Fund Management Directive (AIFMD), and Braemar Estates as the Property Manager.

Braemar Estates directly manages approximately 14% of the leasehold properties within the GRIF portfolio. The remainder of the portfolio is managed by other, unrelated, managing agents.