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Guide to Extending Your Lease – Leasehold Enfranchisement Explained for flat owners

Do you have less than 70 years remaining on your lease?

This is a key number of years and if the answer is 'yes', you should be thinking about extending your lease.

What happens at the end of a lease?

Many people who own leasehold flats are unaware that when the lease runs out, possession of the flat is returned to the freeholder. The situation is similar to hiring a car when on holiday: at the end of the holiday, you return the car to the car hire company. At the end of a 99 year lease, you return your flat to the freeholder. For this reason, as leases become shorter, the value of the property eventually falls to the point where, immediately prior to the end of the lease, the property has little or no value.

Understanding this is important because, if you don't extend your lease, you or a future owner will eventually have to give the flat back to the freeholder. For most people, if their lease runs out in 40/50/60 years' time, extending their lease may not appear to be a priority. However, if you wish to sell or re-mortgage the flat in the next few years you may find that its value has fallen substantially and to protect their own interests, banks and building societies require a minimum number of years to be left on a lease when the mortgage ends.

How do I make my property mortgageable?

In order to preserve or improve the value of your flat you need to extend the lease. This makes your property mortgageable again. Parliament passed legislation, first for houses in the 1960's and then for flats in the 1990's, which provides for the owners of leasehold properties to acquire their freehold if they own a house or to extend the lease if they own a flat.

Do I qualify to extend my lease?

If you have owned your property for more than 2 years, under *The Leasehold Reform, Housing and Urban Development Act 1993* (the 1993 Act) you have the right to a new extended lease. You do not have to occupy the property to qualify to extend your lease. The Act provides for the new lease to be extended for 90 years in addition to the years currently remaining on your lease. For example, if you have 47 years remaining on your lease, you are entitled to a new lease of 137 years. If there is a ground rent, typically £35 per year, this is cancelled and no further payments are made to the freeholder. When the ground rent is reduced to zero it is often referred to as a 'peppercorn rent'.

What do I need to do to extend my lease?

To start the process of extending a lease, if time is not of the essence, the first stage is for you to ask your freeholder, usually through the Managing Agent, the price (often referred to as the Premium) and other terms (mostly legal and valuation costs) that the freeholder proposes for granting a new lease. When you have received their proposal, I can confirm on your behalf whether the price and terms proposed are fair and whether they comply with your rights under current legislation.

Why do I have to pay the freeholder to extend my lease?

To be fair to both you and the freeholder, the 1993 Act provides for the freeholder to be compensated for the reduction in the value of his 'interest' in your property. At first it may be unclear what 'interest' the freeholder has in your flat and a fuller explanation is detailed below. Briefly, the compensation you pay to the freeholder replaces the loss of the ground rent income which would have been collected for the remainder of the lease (the Term), the loss of the future value of the flat when the lease expires (sometimes called the Reversion) and other factors such as 'Marriage Value'. Because your freeholder must grant you a new lease, you are required to pay the reasonable valuation and legal costs incurred by him in dealing with your application. However, if the terms requested are unreasonable or not in accordance with legislation, and an agreement cannot be reached by negotiation, you are entitled to have the issue decided by arbitration.

How do I know if the terms offered are fair?

When you receive the freeholder's proposed terms to extend your lease, I will look at the terms offered and advise you if they are fair and in accordance with your rights under legislation. I often find freeholders will offer you less favourable terms than provided for in the 1993 Act, in order to improve the value of their investment in your property. For example, the freeholder will often seek to retain a ground rent. A typical proposal might include the offer to extend the lease back to the original term of 99 years with a new ground rent (the term 'modern ground rent' is usually used) of between £100 and £250 per year, which is reviewed at intervals throughout the term, often every 20 or 25 years. Some unscrupulous freeholders will seek to double the new ground rent every 10 years and this can have a devastating impact on the value of the property.

The freeholder's offer may initially appear attractive and some of the terms may appear to be lower than you might pay for a 90 year 'statutory' extension. Whilst a shorter term and a modern ground are sometimes included in the final negotiation, care must be taken as this type of settlement can have an adverse effect on the market value of your flat when it is compared with neighbouring properties which have had their lease extended on 1993 Act terms.

The offer from the freeholder requires an immediate reply?

The freeholder's offer letter will often state that a reply is required within a few days, after which their offer will be withdrawn. Whilst it is reasonable for the offer to have an expiry date, more often than not this is a tactic by the freeholder to panic a leaseholder into thinking they must reply or they will lose out. You should not allow yourself to be railroaded into making an instant decision. The terms offered are likely to be heavily weighted in the freeholder's and this tactic should be taken with a 'pinch of salt'. It is worth remembering that the choice to extend your lease is yours, not the freeholder's!

Can I wait for a few years to extend my lease?

Yes. However, if you decide to postpone the purchase of a new lease, you should consider that each year as the lease becomes shorter; the cost of extending is likely to increase. It is also likely that over the coming years, the prices of properties will increase. Both of these factors have a direct bearing on the cost of extending a lease.

How is the value of a new or extended lease calculated?

Many clients have better understanding of why they have to pay the freeholder for a new extended lease when they understand how the Premium figure is calculated. The legislation is drafted so that the freeholder and leaseholder are treated fairly and the freeholder is compensated for his loss of investment income.

The Premium comprises three elements; the first element is ground rent. A typical ground rent for a property with a 99 year starting in 1965 might be £35 per year. As the new extended lease could have no ground rent (sometimes referred to as a peppercorn ground rent), the freeholder is compensated for the annual ground rent he would have collected over the remainder of the term. You will often hear the expression 'Capitalisation'. This is term used to describe the 'lump sum' amount the freeholder receives instead of an annual ground rent.

The second element is the value of the flat. As possession of the property is returned to the freeholder when the lease expires, he would in the future own a valuable asset which he could sell. The freeholder is compensated today, for the money he would receive at the end of the term. This lump sum is calculated by estimating what sum of money would need to be invested today to accumulate at long term compound interest rates over the remainder of the term to the value of your property today. You may come across the expression 'Reversion'. This is a term referring to the fact that the property reverts back to the freeholder at the end of the lease.

The final element is called 'Marriage Value'. It is often established that a flat with a new extended lease is worth substantially more than a flat with a short lease. Sometimes the increase in value is above and beyond the capitalised ground rent and the deferred value of the property, as described above. This additional value is the 'Marriage Value' and legislation provides for this to be shared on a 50/50 basis with the freeholder.

I want to sell my flat but I don't have sufficient funds to extend my lease?

If you wait to approach your freeholder until you have found a buyer for your flat, you will have to extend your lease on the terms the freeholder is prepared to offer you. These terms and the price you pay are likely to be substantially higher than you should be paying. This is because the length of time needed to challenge the freeholder and to benefit from the protection offered to you by legislation can be six to nine months. You are likely to agree more favourable terms to extend your lease if you reach an agreement with your freeholder before you start marketing your property for sale.

Once terms have been agreed, you can then offer your property for sale on the basis of 'extended lease on completion'. Whilst the agreement to extend the lease with your freeholder has to be completed within a reasonable time or the agreement can be withdrawn, there is usually sufficient time to allow you to find a buyer. On the day of completion, your solicitor will arrange to complete the purchase of the new lease and immediately transfer the flat to your buyer. This means you are not required to find the money to extend your lease and you have achieved the best price you can for your flat.

Where can I find more information about extending my lease?

Further general information about extending your lease is available at www.lease-advice.org

I hope that the information given here has been helpful. I offer a full valuation and negotiation service to leaseholders who wish to explore the possibility of extending their leases. The process can be taken one stage at a time, at the leaseholder's discretion.

If you require any further information about the process or costs of extending your lease I would be pleased to hear from you.

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