

The guide to extending your lease

John D Wood & Co has been undertaking leasehold reform work since the original Leasehold Reform Act 1967 and have extensive experience in this specialist area. Extending a lease to a flat has been a statutory entitlement since the Leasehold Reform Housing and Urban Development Act 1993 and we have acted in hundreds of extensions all over London.

Why extend your lease or buy your freehold?

By extending your lease you are helping to safeguard the future value of your property. Whatever the state of the housing market, there are normally four reasons to serve notice sooner rather than later:

- 1 As the lease becomes shorter (e.g. under 70 years).**
As the lease gets shorter, its value starts to drop more sharply, which means the cost of extending the lease rises disproportionately. This is especially true when the remaining lease length is under 20 years.
- 2 If the lease is approaching 80 years remaining.** The cost of the lease extension rises significantly when the lease length drops below 80 years due to the inclusion of 50% of the marriage value (see below), which is not payable in cases where the term left is more than 80 years.
- 3 If the property is to be offered for sale and the lease is comparatively short.** As leases become shorter, banks become increasingly reluctant to provide a mortgage to the buyer. This means that the market for the flat is reduced to a smaller section of buyers, there may be a longer marketing period, and possibly a lower sale price.
 - It is worthwhile considering whether to extend the lease first as buyers fear uncertainty and they will discount their offer to reflect that the final cost is not yet known, especially in a difficult market.
 - Alternatively, obtaining advice on the costs of the lease extension can help to sell a property on its existing lease, by providing the necessary information for a buyer to take on an assignment of a claim.
- 4 Personal circumstances may mean it is an opportune time to act,** for example due to a bond maturing, tax planning requirements, a favourable exchange rate, etc.

What is a statutory lease extension?

Chapter II of the 1993 Act confers the right for the lessee of a flat to acquire a new lease on payment of a premium. The new lease is for a term equal in duration to the unexpired term of the original lease plus an additional 90 years, reducing the ground rent to nil (a peppercorn). The premium is to be calculated in accordance with the provisions the Act.

Do You Qualify?

If you wish to exercise your legal right to extend the lease of your flat, your ownership of the property must have been registered with the Land Registry for at least two years and the original term of the lease must have been at least 21 years. It is important the validity of your claim is checked by a specialist solicitor before you serve notice to extend the lease. If you are buying a property and do not want to wait the two years before qualifying you may ask the current owner, if they qualify, to serve notice on your behalf and assign a claim to you upon completion.

How Much Will It Cost?

Before you serve notice you will want to know how much the extension is going to cost.

The Freeholder (and intermediate Landlords, if there are any) must be compensated for the loss of their interest(s). Your lease gives you the right to use your property as long as you comply with the lease terms. The Freeholder or competent landlord has the right to the property when your lease expires, and until then, to draw an income from it (the ground rent). The size of the premium will be dependent on how soon the freeholder will regain possession (ie: the length of the lease), the value of the property, and the size of the ground rent.

The valuation date for the calculation is the date the Freeholder receives the notice of claim and this 'stops the clock' and prevents the premium rising due to the further reduction the term. It will also safeguard against price rises in the market. We specialize in this area of valuation and we now set out a summary of the various elements, which must be calculated to arrive at the premium payable to the landlord.

Calculating the Premium

Looking at a simple case, to calculate the premium we need to do the following:

Establish the Hypothetical Freehold Value

The starting point for calculating the premium is the value of the flat on hypothetical freehold basis. It's a freehold, because the Freeholder has the reversion into perpetuity even though the freehold interest to a flat cannot be sold in this way. We have to make some assumptions that lessees' improvements are disregarded – it is to be assumed that the flat is in good, well maintained condition but not improved. This is to prevent the lessee paying twice for improvement works they have made. There has been much case law to establish what may be excluded. The Hypothetical Freehold

Value is usually established by analysing transactional evidence of similar properties sold on a long lease or with a share of freehold around the same time of the claim.

Calculate the Reversionary Interest

At the end of the lease the Freeholder has the right to regain possession of your property. This is known as the reversionary interest because the property reverts to the Freeholder. To calculate the value of the reversionary interest, the estimated Hypothetical Freehold Value is discounted over the length of the existing lease to a present value by using a deferment rate (also known as a discount rate or reversionary yield).

As an example, if a property is worth £3 million 'freehold' at the end of a 20 year lease you would now have to invest a lump sum of around £1,130,000 at a rate of 5.00% for 20 years to achieve the same sum. The reversionary interest is therefore £1,130,000 in this example.

We then carry out a similar calculation but using the expiry date of the new lease after the 90 year extension. The loss to the Freeholder is the difference between these two figures, or in other words, this is the diminution in the value of the Freeholder's reversion.

Calculate the present value of the Ground Rents

The ground rent is an income stream which the Freeholder is entitled to receive from the Leaseholder throughout the term of the original lease. From completion of the new lease the ground rent will be a peppercorn (nil), and therefore the Freeholder will have to be compensated for losing this income stream.

Ground rent income streams are capitalized to arrive at a present day lump sum value, i.e. if the Freeholder is entitled to receive a ground rent of £500 per annum for 60 years, without review, this would equate to a present day lump sum of approximately £8,000 at a 'normal' 6.00% yield.

Calculate the Marriage Value (if applicable)

In cases when the lease is under 80 years unexpired, the premium will include Marriage Value. This is the synergistic value created by "marrying" the lessee's and the landlord's interests, and is the difference between the aggregate of the parties' interests before the lease extension and the aggregate of all the interests after the lease extension. The total after the lease extension is higher than the current interests, and 50% of this additional value will be payable to the landlord(s).

How do I proceed?

Step 1 - If you qualify, having owned the property for more than two years, and the lease was originally granted for in excess of 21 years, instruct us to advise on the cost of extending the lease. If verifying the qualifying position is difficult, it may be sensible to instruct a specialist solicitor prior to obtaining valuation advice.

Step 2 - Once you are aware of the potential costs, a specialist solicitor should prepare the Notice of Claim which includes the Offer Price we recommend is used initially.

Step 3 - The solicitor will serve the notice on the relevant Landlord(s). A deposit of 10% of the offer price will be demanded and the Leaseholder will be liable for the reasonable valuation and legal fees of the Landlord(s) arising from the claim.

Step 4 - The Landlord will serve a counter notice admitting the claim is valid and will inevitably propose a higher premium.

Step 5 - Negotiations then commence between John D Wood & Co. and the Landlord's surveyor(s) (in most cases there will only be one). If no agreement can be reached within six months of the date of the counter notice, an application needs to be made to the First-tier Tribunal. This application is essential to protect the claim from being deemed withdrawn. Your solicitor will negotiate the terms of the lease within the same negotiation period. We would advise you whether there is merit in taking the matter to the Tribunal, although in most cases it is sensible to pursue a negotiated settlement.

Step 6 - Once all terms are agreed (valuation and lease terms) a completion window of two months begins. This can usually be extended to a maximum of four months, but most leaseholders will choose to complete sooner.

Why John D Wood & Co.?

We always seek to give our clients the best advice. This advice will be dependent upon the individual circumstances of our clients, the length of their lease, and the considerations of various movements in the residential property market. In certain circumstances our clients have even been advised it may be financially beneficial to withdraw from an active claim even after allowing for all the abortive costs. The most important thing is for us to ensure our clients take the best course of action. This can be a complex area of valuation and is constantly evolving, so it is essential you take the appropriate specialist advice.

Contact

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