Residential leasehold reform: the first wave breaks in a swelling tide of residential leasehold reform proposals

In our Talking Points article of July 2019, entitled "*Residential leasehold reform – is change on the horizon?*", we set out the key points to be aware of in respect of reforms which were being proposed at that time in respect of residential long leases, and suggested that the Government may choose to intervene with new legislation. Such legislation has now been introduced – in short, it bans ground rents from being anything more than one peppercorn in residential long leases which are entered into on or after 30 June 2022 (subject to certain exceptions) – and it may be that a further wave of residential leasehold reform is to be expected…

1. In a nutshell, what does the new legislation do?

The Leasehold Reform (Ground Rent) Act 2022 (the "**Act**") – which came into force on 30 June 2022 in England and Wales – prohibits ground rents in most new residential long leases from being anything more than a peppercorn. In essence, this means that no money can be charged as ground rent in most long residential leases which fall within the ambit of the Act.

2. The detail

Described by the Government as being "*part of the most significant changes to property law in a generation*", the Act restricts the ground rents which can be charged on "new" residential long leases (being residential leases of a single dwelling which are granted on/from 30 June 2022 for a term in excess of 21 years and granted for a premium) to a token peppercorn per year (effectively, zero in monetary value). Any attempt to reserve a ground rent of any financial value in a lease will take effect as a peppercorn only.

As an anti-avoidance measure, landlords of residential long leases are also prohibited from charging an administration fee for collecting a peppercorn rent.

3. Are there any exceptions or exclusions?

Yes – the Act does not apply to business leases, statutory lease extensions, community housing leases and home finance plan leases.

The ground rent restrictions also do not apply to leases granted pursuant to contracts which were exchanged before 30 June 2022 – so, by way of example, if a landlord and a tenant entered into a contract for the grant of a residential long lease which reserved a ground rent of (say) £500 per annum, and the contract was entered into before 30 June 2022 (with the lease then being entered into on or after 30 June 2022), then the lease will fall outside the scope of, and thus be unaffected by, the Act.

Note that whilst the Act encompasses retirement home leases, transitional measures apply to such leases (and thus the prohibition on ground rents in these leases will not come into force before 1 April 2023 – we await further details on this).

4. What about residential long leases which are dated before 30 July 2022 and which reserve a monetary ground rent?

Crucially, the Act does not apply retrospectively – and, therefore, it does not apply to residential long leases which are entered into before 30 June 2022.

As such, any residential long leases which do reserve a monetary ground rent will remain unaffected by the Act so long as they are dated on or before 29 June 2022 (or entered into pursuant to a contract dated on or before 30 June 2022, as noted above).

Of course, if the parties to a residential long lease wish to vary it voluntarily (for example, to remove or amend monetary ground rent provisions in such lease) then they are free to do so – indeed, we have already witnessed this happening in the market (see Section 8 below).

5. What about other sums which are reserved as a rent under the residential long leases?

The focus of the legislation is "ground rents" – namely, a payment to be made to the landlord under a long residential lease which does not attach to any service provided in return for such payment. The rent need not be specifically labelled as "ground rent" in the lease itself (indeed, the Act does not use the term "ground rent") – simply, it includes anything which is "*in the nature of a rent, whatever it is called*".

Note that sums payable under a lease in respect of service charge, insurance, rates, council tax, outgoings and any other ancillary matters do not constitute rent for the purposes of the Act (even if such items are expressed to be reserved as rent under the terms of the lease) – this is to "*avoid restricting legitimate charges that might be reserved as rent*".

6. What are the consequences for failure to comply?

The Act gives enforcement authorities the power to impose fines of between £500 and £30,000, for each qualifying lease, where the enforcing authority is satisfied – beyond reasonable doubt – that there has been a breach of the Act (i.e. where landlords demand monetary ground rent in contravention of the Act and do not return payment within 28 days).

7. Will the law of unintended consequences apply?

The Act was passed following widespread publicity over the rising tide of discontent over ground rents: namely, complaints from residential leaseholders that ground rents had been set at what were perceived to be exorbitant levels and were escalating at regular intervals throughout the term of the lease. Therefore, at first blush, prospective residential long leaseholders may welcome this new addition to the statute books on the basis that landlords will now be prohibited from charging (and thus such residential leaseholders will not be required to pay) any ground rents. However, this may result in an increase in the prices of the residential long leases of flats and houses themselves as residential developers seek to make up for a lost income stream.

It may also be the case that demand from prospective buyers increases for residential leasehold properties which are regulated by the Act, to the detriment of residential leasehold properties which are not (which, again, may serve to drive up prices of new residential leasehold flats and houses which fall within the ambit of the Act). Given that the genesis of the Act was in response to an outcry over long residential leases which are stated to contain onerous ground rents which "*materially [affect] a leaseholder's ability to sell their property or obtain a mortgage*", it seems both regrettable and ironic that the Act may serve to exacerbate such issues if existing residential long leases which reserve financial ground rents become even less attractive and thus even less marketable by virtue of the Act.

Of course, the business models of those who rely on the collection of ground rents will also be impacted – although, again, perhaps in a manner not wholly intended. In addition to the law of unintended consequences, we may also witness the manifestation of the law of supply and demand: it may transpire that investors in existing residential ground rent portfolios see an increase in the value of their existing investments, given that new residential ground rent opportunities will now dry up as a result of the Act.

8. Next steps?

Whether the Act will represent the opening of the dam on residential leasehold reform remains to be seen. Certainly, the Act has been billed as the first wave of the Government's plans for residential leasehold reform (with a second wave promised within this parliament – namely, by 2024) – and so developers, landlords, prospective and existing residential leaseholders, investors and lenders will need to keep a close watch on future reforms of the type summarised in our previous article.

It may be that the market steps in to address the existing challenges in a manner which obviates the need for any further expansions to the statute book. Notably, some developers have already voluntarily established schemes to assist leaseholders who may be facing onerous ground rents – for example, by varying leases to: (a) remove the ground rent clause (pursuant to which the ground rent doubles every ten years) and (b) replace it with one whereby the ground rent increases in line with the Retail Price Index every 25 years. Absent such corrections by the market, bringing forward the second wave of legislation may be yet another item to add to the new Prime Minister's ever-increasing "to do" list.

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