

# GROUNDNS FOR DISAGREEMENT

Originally the result of leases sold by the owners of landed estates to speculative builders in the early 1900s, ground rents are now a feature of Victorian house conversions, apartment blocks and modern estates.

Owners of ground rents include developers, local authorities, trustees of probate estates, and specialist investment companies.

## What are ground rents?

A ground rent is created when a residential unit is sold on a long leasehold, rather than freehold, basis. Landlords paying ground rent will typically own leasehold apartments in new schemes or sub-divisions of period houses. The owner of the freehold is entitled to receive a ground rent from the long leaseholder, and may additionally be entitled to recover the cost of insurance and management.

The value of the ground rents is typically 1-2% of the gross development value of the apartment scheme, and payment of ground rent is made annually.

Conflicts of interest can arise when the ground rent owner also provides management services to maintain the common parts of the building or the estate – for example, lifts, entrance lobby and communal grounds. External managing agents would normally be employed.

## Management

The Rugg Report proposed compulsory licensing for managing agents to drive up standards in the care of apartment schemes, but stopped short of calling for compulsory registration of all ground rent owners.

Currently, managing agents do not even have to belong to their industry body, the Association of Residential Managing Agents (ARMA). Yet the image of the ground rent industry is closely allied to that of managing agents, as they represent the

**Ground rents are a widely owned but poorly understood type of property. Jeremy Davies explains investments where landlords are more likely to be the ones paying out**



Ground rents are paid annually by individual leaseholders to the landlord for the right to have their apartment in the landlord's block and on the landlord's ground

## GROUND RENTS AT A GLANCE

- Ground rents are also known as reversionary investments. Most landlords would know them if they have invested in 'buy-to-let' apartment schemes in cities.
- These individual leases provide for an annual payment, known as ground rent, that provides a source of income to the freeholder.
- It is this accumulative income which attracts investors and which also funds the repairs and maintenance of the 'common parts' of buildings and estates. However, many owners of ground rents prefer to economise on their responsibilities and some managing agents have a shocking reputation.
- Failure to pay ground rent can result in forfeiting the property, as payment of it is usually a condition of buying the lease. While the freeholder can normally only start proceedings if you owe more than £350, some leaseholders withhold ground rent as protest about the way the building has not been properly repaired and maintained.
- As well as receiving regular income, the freeholder has the right to get the apartments back when the leases eventually expire, so the closer the properties are to reverting to the freeholder, the greater the sale value of each ground rent.
- It is a criminal offence for long leaseholders not to be given the opportunity to get together to buy the ground rent.
- Both individual ground rents and portfolios of ground rents are of interest to a number of ground rent purchasers. Some estate agents also offer specialist broking services.
- The Leasehold Advisory Service may be helpful if you run into problems with the freeholder: [www.lease-advice.org](http://www.lease-advice.org)

landlord in correspondence with leaseholders and are responsible for the maintenance of buildings.

Ground rents are tradeable: they can, and are, regularly bought and sold.

Transactions are subject to legislation which gives the long leaseholders the right to match the sale price. These are known as Section V notices, and mean that any ground rent sale must be delayed for two months while the notice period for the right of first refusal expires. If long leaseholders wish to take up their rights to buy, they then have a further two months to nominate a purchasing entity.

The long leaseholders require at least 50% participation, so the bigger the scheme the lower the likelihood of take-up.

**The Rugg Report: proposes compulsory licensing for managing agents**

*The Private Rented Sector:  
its contribution and potential*

Julie Rugg and David Rhodes

Centre for Housing Policy The Universities of York

## Credit crunch

In some cases, a residential developer will have formed a Special Purpose Vehicle to develop an apartment scheme. They are often keen to wind up the companies to reduce accountancy fees in future years and cut down on paperwork, and so will often have sold the ground rents at an early stage.

But some, after a successful sale of apartments (say in the boom years of 2002-2006), might have given little thought to selling, or in some cases even collecting, the ground rents. That is certainly not true in today's harsher times.

It is also the case that developers are now increasingly looking to make strategic land

purchases from distressed vendors, and the receipts from ground rent sales provide the means.

Ownership of ground rents benefits from economies of scale. The business consists of collecting small amounts of money from a large variety of people, some of whom may be baffled by the arrival of a ground rent invoice.

In addition, legislation governing the administration of rental demands for ground rents differs from that of more straightforward residential properties: commonly, invoices are now accompanied by four A4 sides of statutory paperwork.

The opportunity to deploy the capital better elsewhere, especially in the current economic climate, is also high on a ground rent owner's list of priorities. Banks are reluctant to lend on individual ground rents, and so most owners are unable to 'gear them up' to maximise returns. As people seek to reduce the loan to value ratio of their residential mortgages, they are increasingly looking to sell non-core assets to free up cash.

## What are ground rents worth?

The value of a ground rent is a combination of the passing income and the unexpired term on the lease. The income receivable annually as ground rent is more valuable if it has frequent rent review provisions, or goes up with inflation. The shorter the lease length remaining, the higher the value of the ground rent, as the nearer the property is to reversion.

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## PAY-AS-YOU-GO BLOCK MANAGEMENT

A new 'lite' block management scheme has been launched to reduce service charges in buildings with up to ten apartments.

Charges will be on a pay-as-you go arrangement, designed to save residents and owners hundreds of pounds each year.

Chainbow Lite will only bill for services conducted when leaseholders have requested maintenance, gardening, cleaning or other jobs. The reactive service bucks the mainstream trend of paying service charges and often seeing no work done to maintain or repair the 'common parts' of the building – something that annoys tenants and landlords alike.

We have heard stories of landlords unable to let units because poor external maintenance has meant dampness, and being billed for thousands of pounds for scaffolding that stayed up for weeks on end when the work itself took only a few days.

Another feature of the Chainbow service is that the firm puts all its bills on an intranet with a breakdown of costs, so that everyone can see exactly what they are paying for.

Chainbow Lite is, unfortunately, only available in London, but owners of apartments in smaller blocks elsewhere might like to see whether a similar option might be explored locally.