

## The Guide to Extending your Lease or Buying your Freehold

### Why extend your lease or buy your freehold?

By extending your lease or acquiring your freehold 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:-

- If a lease has become very short, i.e. under 20 years, the relative value of the lease starts to drop quite sharply, which means any further delay may be costly as the price of extending the lease or buying the freehold rises disproportionately.
- If the lease is approaching 80 years remaining in length. As the lease drops below 80 years, even by a single day, the cost of the lease extension/freehold rises exponentially due to the inclusion of 50% of the marriage value (see below).
- If the property is to be offered for sale and the lease is comparatively short it is also worthwhile considering serving notice as buyers fear uncertainty and will accordingly discount the level of their offer, especially in a difficult market. Therefore, it should increase the marketability of the property.
- Personal circumstances might suggest it may be an opportune time to act, for example due to a bond maturing, tax planning requirements, favourable exchange rate, etc.

### Do You Qualify?

If you wish to exercise your legal right to extend your lease of your flat or buy the freehold of your house, your ownership of the property must have been registered with the Land Registry for two years and the original term of the lease must have been granted for at least 21 years. There are some exceptions and it is important the validity of your claim is checked by a specialist solicitor before you serve the legal notice upon the Freeholder to buy the freehold or extend the lease.

If you are buying a leasehold 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 the right to you upon completion.

### How Much Will It Cost?

Before you serve notice you need to know how much it is going to cost. Under current legislation the Freeholder must be compensated for the loss of their interest i.e. in other words you must pay a 'premium' for the extended lease or freehold. The size of the premium will be dependent upon the 'unimproved' value of the property, the lease length, the ground rent and possibly "other loss". The valuation date is the date upon which the Freeholder receives the notice to extend your lease or buy the freehold and this 'stops the clock' and prevents the lease from running down whilst the claim progresses.

## How do I proceed?

### **Step 1**

If you qualify and have owned the property for more than two years and the lease was originally granted for in excess of 21 years, instruct John D Wood & Co. to explore the cost of extending the lease/buying the freehold.

### **Step 2**

Once you are aware of the potential costs, you should instruct a specialist solicitor to check you are legally entitled to claim a 90 year lease extension or to buy the freehold prior to serving the statutory notice upon the Freeholder.

### **Step 3**

The solicitor will prepare and serve notice upon the Freeholder and all superior interests. A deposit will be demanded and the Leaseholder will be liable for the Freeholder's reasonable valuation and legal fees in response to the claim.

### **Step 4**

The Freeholder will serve a counter notice admitting the notice is valid and inevitably propose a higher premium.

### **Step 5**

Negotiations then commence between John D Wood & Co. and the Freeholder's surveyors. If no agreement can be reached an application can be made to the Leasehold Valuation Tribunal.

### **Step 6**

Once the premium is agreed the solicitors prepare the legal documentation.

### **Step 7**

The premium is paid and legal completion takes place (normally between six months to a year after notice is served).

## How is the Premium Calculated?

We specialize in this complicated area of valuation and below is a summary of the various elements, which must be calculated

to arrive at the premium payable (P) to the Freeholder.

### **The Unimproved Freehold Value (UFV)**

The starting point for calculating the premium is the freehold or long lease value of the property. Under the legislation tenant's improvements can be discounted from the calculations and there has been much case law to establish what can and cannot be excluded.

### **Reversionary Interest (R)**

At the end of the lease the Freeholder has the right to regain possession of the 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 long lease/freehold unimproved value (UFV) of the property is discounted over the length of the lease to a present value by using a deferment rate (also known as a discount rate or reversionary yield). At the end of the current unexpired term the Freeholder could sell the flat/house on a new lease and this "interest" has a current value. 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 £1,185,000 at a rate of 4.75% per annum for 20 years to achieve the same sum. With a flat, the Freeholder still retains a reversionary interest at the end of the extension therefore the calculation is to establish the diminution in their reversionary interest. Please see table opposite which shows key Tribunal decisions on deferment rates and their impact upon the cost of the premium.

### **Ground Rent (G)**

The ground rent is an income stream which the Freeholder is entitled to receive from the Leaseholder. Ground rent income streams are capitalized to arrive at a present day lump sum value, i.e. if the Freeholder was entitled to receive a ground rent of £500 per annum for 60 years, without review, this would equate

to a lump sum of approximately £8,000 (this is the lump sum which would have to be invested today to generate the income stream at 6% for the next 60 years).

### The Leaseholder's Interest (L)

The Leaseholder has the right of occupation for the term of their existing lease (but without rights to extend) and this has value. The longer the lease the greater the intrinsic value to the Leaseholder.

### Marriage Value (M)

The marriage value is calculated by adding together the Leaseholder's interest (L), together with the existing interests of the Freeholder, which are the reversionary interest (R) and the capitalized ground rent income stream (G) and these are subtracted from the long lease/freehold value (UFV) or  $M = UFV - (L + G + R)$ . There should be a theoretical difference (the marriage value) which is split 50:50 between the Leaseholder and the Freeholder. The Freeholder is only entitled to this marriage value if the length of the unexpired lease falls below 80 years at the date of valuation. Hence, it is imperative to extend or buy the freehold prior to the lease falling below 80 years, even by a single day.

### The Calculation of the Premium

The Premium payable to the Freeholder is the discounted reversionary interest plus the total of the capitalized ground rent income stream plus 50% of the marriage value (where applicable) and other loss (if applicable).

$$P = R + G + M/2$$

### The Impact of Deferment Rates

Let us consider the estimated cost of a lease extension or enfranchisement for a Leaseholder with a variety of years remaining on the lease at different price levels of the market. The figures below show how the estimated cost varies, depending upon the years remaining and the deferment rate used (due to decisions from various Tribunals). We have looked at flats worth £400,000 and £1,000,000 and a house worth £3,000,000, for the freehold unimproved/long lease interests with vacant possession. The ground rent is fixed at £100 per annum without review for all examples and John D Wood & Co.'s relativity graph was utilized in ascertaining the existing leasehold value (without rights) at the different lease lengths.

YEARS REMAINING	PRE-ARBIB	POST-ARBIB	POST-SPORTELLI	POTENTIALLY TO
<b>FLAT VALUE OF £400,000 UFV*</b>	<b>6%</b>	<b>4.75%</b>	<b>5%</b>	<b>7%</b>
20	£157,605	£173,482	£170,067	£147,214
50	£59,588	£68,296	£66,138	£55,562
82	£5,000	£10,823	£9,193	£3,207
<b>FLAT VALUE OF £1 MILLION UFV*</b>	<b>6%</b>	<b>4.75%</b>	<b>5%</b>	<b>7%</b>
20	£393,153	£432,749	£424,234	£366,990
50	£147,789	£169,316	£163,975	£137,723
82	£10,021	£23,969	£20,038	£5,331
<b>HOUSE VALUE OF £3 MILLION UFV*</b>	<b>6%</b>	<b>4.5%</b>	<b>4.75%</b>	<b>6.75%</b>
20	£1,180,781	£1,335,115	£1,306,076	£1,119,268
50	£442,221	£527,053	£508,313	£418,028
82	£26,890	£83,368	£68,814	£15,544

\* Unimproved Freehold Value

N.B. For Guidance purposes only

## Why John D Wood & Co. ?

John D Wood & Co. only represent leaseholders and has been advising clients since the Leasehold Reform Act 1967 was implemented.

We always seek to give our clients the best advice. This advice will be dependant upon the individual circumstances of our clients and the length of their lease. Consequently, due to the uncertain outlook for property in the short to medium term we offer our clients a Sensitivity Analysis, which charts the effects of various movements in the residential 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 is a complex and evolving area of valuation and it is essential you take the appropriate specialist advice.**

## Contact

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**John D Wood & Co. only represents Leaseholders and is one of the leading experts in extending leases and acquiring the freehold interest (enfranchisement). We have been advising clients since the Leasehold Reform Act 1967 was implemented.**

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