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33 Wigmore Street, London W1U 1QX | T +44 (0)207 723 8881 | F +44 (0)207 691 7909 | E info@longharbour.co.uk

Mr Clive Betts MP
Chair of Housing, Communities and Local Government Select Committee
House of Commons
London
SW1 0AA

11th January 2019

Dear Mr Betts,

Re: Leasehold reform inquiry

I am writing to thank you for inviting me to appear before your Committee to give oral evidence for your inquiry into leasehold reform on 19th November 2019. During the session I promised I would follow up with additional detail around two specific points:

1. Historic analysis of ground rents; and
2. Statistics on the revenue generated by Long Harbour's ground rent fund.

Historic analysis of ground rents

As we have argued consistently, onerous ground rents (which double in value over periods of less than 20 years) should have no place in a well-functioning leasehold system. However, we believe a correction is necessary in relation to the historical context of ground rents as a whole. Drawing on your questions in the previous session, I discussed what a ground rent was ten or twenty years ago compared to today in order to contextualise this debate.

Ground rents have never been "nominal" and the level of today's ground rents is in keeping with historical levels. While the evidence we have compiled is by no means exhaustive, we have examined leases in our portfolio and those of two other institutional freeholders. We would expect that further evidence would reinforce our findings, that the unacceptable practices in relation to ground rents that double more frequently than 20 years are exceptional rather than the norm and that current levels of ground rents are otherwise low by historical standards.

Our analysis shows that when looking at starting ground rents as a proportion of prevailing house prices and wages, ground rents are no higher now than they used to be. In 1953 the small sample we have analysed shows that starting ground rents were 0.80% of average wages, while in 2018 a much larger sample suggests that starting ground rents represent 0.73% of average wages. In relation to the last twenty years, where we have a larger sample of leases to consider, it is worth considering the following figures, which show that ground rents as a proportion of house prices and wages have been stable.

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Year	Starting GR	House Prices	Wages	Unit Count	% of HP	% of Wages
1953	£7.77	£1,891	£484	82	0.41%	1.61%
1963	£16.74	£2,748	£842	737	0.61%	1.99%
1973	£25.26	£8,396	£2,179	1,917	0.30%	1.16%
1983	£83.15	£26,307	£7,665	3,032	0.32%	1.08%
1993	£93.18	£50,128	£16,479	3,908	0.19%	0.57%
2003	£202.92	£119,938	£25,438	21,062	0.17%	0.80%
2013	£367.85	£163,056	£32,365	6,200	0.23%	1.14%

Sources: average house prices: Nationwide
average wages: ONS

Revenue generation

With regards to the revenue generated by the ground rents Long Harbour has acquired on behalf of its pension fund clients, the statistics are as follows:

- For the financial year ending 31st March 2018, ground rents collected amounted to £28.2m, which equates to approximately £176 per lease on average. This rent is delivered to the pension schemes that have invested in the assets and is not retained by Long Harbour.

- In return for receiving the ground rent income, the leasehold management and stewardship function for the fund is undertaken by Long Harbour's associated company, Homeground Management Limited. Its financial position can be summarised below, from its latest audited accounts (as at 31st December 2017):
  - Turnover: £4,060,210
  - Operating profit: £441,935
  - Taxation (paid): £101,058
  - Net Profit: £340,877

Lending on 0.1% ground rent

The other point to pick up that was discussed during our session, and later referred to in your letter 21.11.18 to the house builders (Taylor Wimpey, Bellway & Persimmon), was in relation to lending criteria and whether a ground rent has *"a material effect on the saleability or mortgageability of a property"*. It appears that you have unilaterally defined an onerous ground rent as one which exceeds 0.1% of the property value. We would like to know where this figure has come from, and what evidence has been gathered. Does this mean that a property worth £190,000 and has a ground rent of £200 per annum, is to be defined as onerous?

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This is an incredibly dangerous assertion to make in the context of a functioning leasehold market of 4.3 million properties. This definition does not correlate with our experience of dealing with thousands of property transfers every year, and it is at odds with within current lending guidelines (as evidenced in the attached report). We would strongly urge you to reconsider the way you have defined onerous to prevent damaging existing leasehold values across the country.

From reading the submissions to your inquiry, we can see that there are some leaseholders who are unable to sell their properties due to the way the ground rent is reviewed. This is a legitimate problem; these leaseholders must have redress and a means to normalising their ground rent review. It is something we have been leading with our peers in the industry, and we provided evidence to you on the significant progress made. In short it is a small and ever-diminishing problem, with the vast majority of leaseholders having access to redress. We are however concerned that this isolated issue is being overstated, and risks damaging a functioning property market through a ripple effect. I refer you back to our written submission that lays out the makeup of the market and that doubling leases make up less than 0.3% of all leaseholds.

To further our understanding we undertook a review of the top 20 UK mortgage lenders (responsible for 93% of overall lending in 2017). For those providers for whom data was available, **all** will lend against leasehold flats and houses while eight of the 20 lenders will not lend against a flat in a commonhold development. 19 of the lenders will lend against ground rents which increase with RPI, and 16 lenders will lend if the ground rent is more than 0.1% of the property value. We attach a copy of this report for your information.

Despite the limitations in the number of providers willing to provide finance secured against a commonhold flat, it is clear that for both tenures – leasehold and commonhold – access to mortgage finance presents no real difficulty, with a clear industry preference for leasehold. This goes to reinforce the point that government must be measured in its reform and not to let an isolated issue contaminate the whole system to the detriment of the vast majority of home owners. I enclose with this letter an independently commissioned piece of research into leasehold property lender criteria.

Further to these points, I would like to reiterate my support for reform and several of the Government's specific proposals, including the banning of new-build leasehold houses, the elimination of onerous ground rents and the improvement, and ideally regulation, of management practices.

As mentioned during the session, Winckworth Sherwood, a specialist property law firm, has developed a comprehensive Code of Practice in partnership with industry (a copy of which was provided to the Committee ahead of the evidence session on 19th November). This will enshrine high quality management practices and instil robust consumer protections.

The Code details seven tangible outcomes which will assist stakeholders in mitigating against miss-selling of properties and, if adopted by the Secretary of State and incorporated into legislation under S.87 of the Leasehold Reform, enshrine in law the responsibilities of landlords, property managers and investors.

This will ensure freeholders can serve as long term responsible stewards of properties, holding managing agents to account and ensuring consumers, albeit leaseholders or tenants, are not affected by the bad practices that led us to this point today.

I would like to thank you again for inviting me to give evidence, I would be more than happy to come back and appear before the Committee or provide any additional information you require throughout the process.

Yours sincerely,

Richard Silva
Executive Director

Leasehold Property Lender Analysis

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Introduction

- Long Harbour and their clients commissioned Holder & Combes Mortgages to conduct research on leasehold property lending criteria in the UK mortgage market.
- Our brief and the aim of the research was to review lending criteria in respect to property types, ground rents, unexpired leases, service charges and affordability.
- The findings are to be used to understand the impact criteria is having on the ability to lend.

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UK Finance

- UK Finance is the trade association formed on 1st July 2017 to represent the banking and finance industry operating in the UK.
- It was the result of the merger of the British Bankers Association, Payments UK, the Council of Mortgage Lenders, the UK Cards Association and the Asset Based Finance Association and represents more than 250 firms in the UK providing credit, banking and payment-related services.
- In 2017 UK Finance confirmed they have 65 members providing data on mortgage lending.

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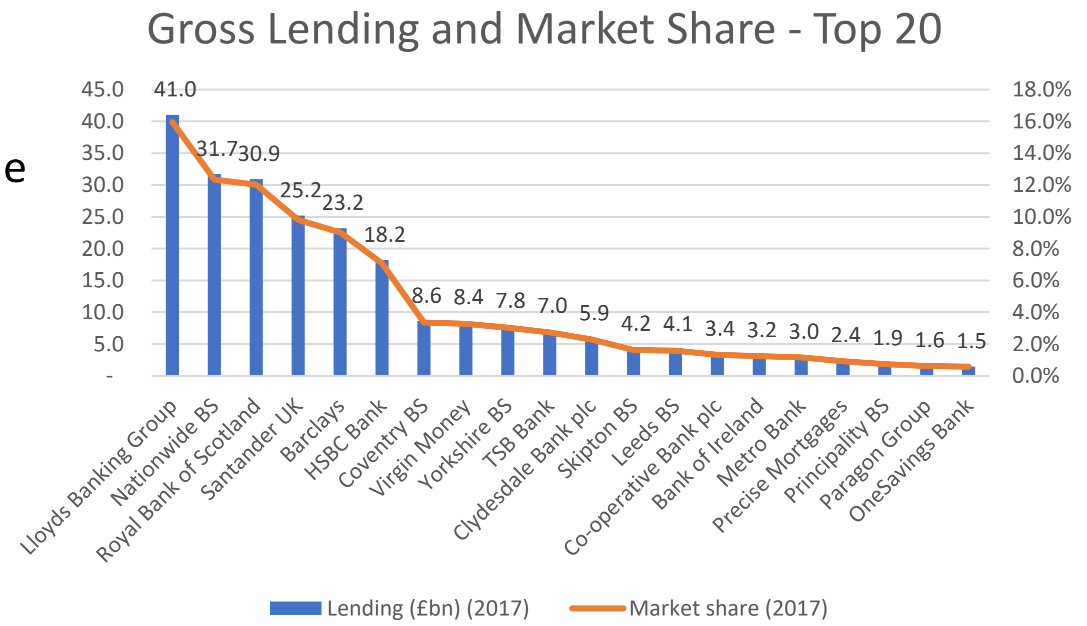
UK Gross Lending Overview

- UK Finance mortgage data for 2017 confirmed gross lending of £257bn, up 4% from 2016.
- In 2017 the top 20 providers made up 91% of lending, equating to £233.20bn.
- Based on market share alone, Lloyds Banking Group (LBG) continues to hold the largest mortgage book with 16% of the market.
- Therefore we have focused our research on the top 20* lenders within the market.



	(£bn)
Total Gross Lending In 2017 UK	£257.00
Total Lending by top 20	£233.20
% share of total lending by top 20	91%
% share by other	9%

Source: UK Finance

*Top 20 refers to 23 lenders as LBG consists of Halifax, BM Solutions, Scottish Widows and Lloyds Bank.

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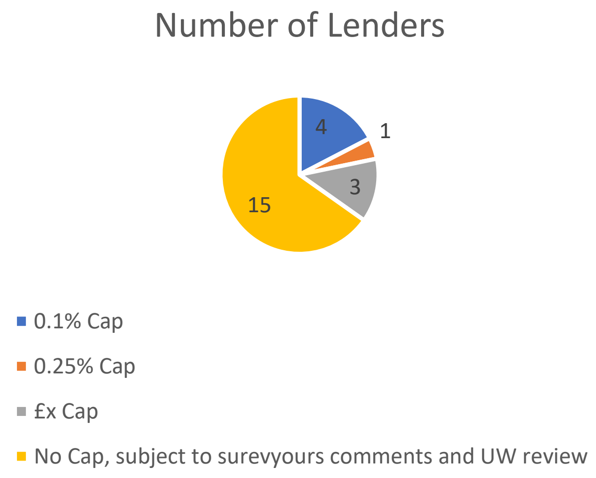
Maximum initial ground rent

In 2017, all lenders in the top 20 lend on leasehold flats and leasehold houses.

Mortgageability assessment of ground rents show:

- 14 of the top 20 lenders have no cap and each case is subject to surveyor comments and underwriter review
- Only 1 of the top 20 lenders have a ground rent cap of 0.25% of property value
- 4 of the top 20 lenders have a ground rent cap of 0.1% of property value
- 3 of the top 20 lenders have a monetary ground rent cap



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Ground Rent Doubling

- 19 of the top 20 lenders will review the property on a case by case basis and is subject to surveyor comments and underwriter review.

- The remaining lenders will not accept ground rent doubling.

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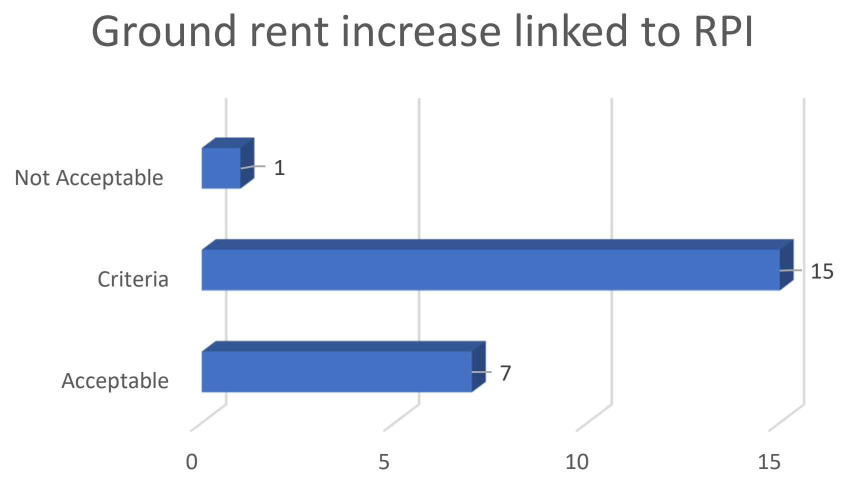
Ground Rent Escalating

- Only 2 of the top 20 lenders will not accept ground rent escalation
- All remaining lenders will review the property on a case by case basis and will be subject to surveyor comments and underwriter review

Ground rent increase linked to Retail Price Index (RPI)

- RPI is the most accepted form of ground rent increase with only one lender (HSBC) who would not consider ground rent increase linked to RPI



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Is service charge factored within the lender affordability model?

- Only BM Solutions & Paragon Group would not consider service charge within their affordability model.
- All remaining lenders incorporate service charge costs within their affordability model.

Lending to a flat in a commonhold development

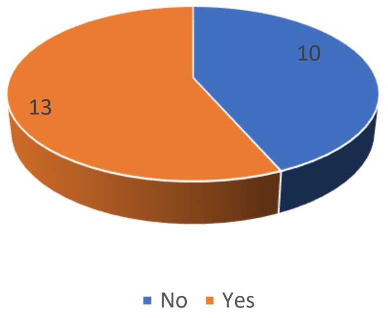
What is a commonhold development?

Commonhold is a new type of property ownership, an alternative to the long leasehold system. It allows freehold ownership of individual flats, houses and non-residential units within a building or an estate. Ownership is not limited by time as it is with a lease.

The rest of the building or estate forming the commonhold is owned and managed jointly by the flat or unit-holders, through a commonhold association.

- Almost half of the lenders will not consider lending to a flat in a commonhold development.

Lender split for lending to a flat in a commonhold development



Source: LEASE-advice.org

Remaining term on lease

Lender criteria is most differing within this area.

Within the top 20, the following measures are in place:

- Minimum lease of 70/75/85 years from application
- 55 years from application subject to at least 30 years remaining at the end of the mortgage term
- Mortgage term plus 25/30 years, remaining lease from application
- More than 30 years remaining on application
- Either 50 years or mortgage term plus 25 years, whichever is the greater
- 50 years at the start of the mortgage and at least 50 years at the end
- Minimum 50 years must remain at the end of mortgage term

The most widely shared criteria was an unexpired lease term of 85 years from application, shared by 7 of the top 20 lenders.

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Lender	Halifax (Lloyds Banking Group)	BM Solutions (Lloyds Banking Group)	Scottish Widows (Lloyds Banking Group)	Lloyds Bank	Nationwide BS	Royal Bank of Scotland	Santander UK	Barclays	HSBC Bank	Coventry BS	Virgin Money	Yorkshire BS	TSB Bank	Clydesdale Bank plc	Skipton BS	Leeds BS	Co-operative Bank plc	Bank of Ireland	Metro Bank	Precise Mortgages	Principality BS	Paragon Group	OneSavings Bank
Rank	1	1	1	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Ground Rent - Maximum initial ground rent	🕮	🕮	🕮	🕮	%	🕮	🕮	%	🕮	🕮	🕮	£	🕮	🕮	🕮	%	%	🕮	%	£	🕮	£	🕮
Ground Rent - Doubling	🕮	🕮	🕮	🕮	×	🕮	🕮	🕮	×	🕮	🕮	🕮	×	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	×	🕮
Ground Rent - Escalating	🕮	🕮	🕮	🕮	×	🕮	🕮	🕮	×	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮	🕮
Ground Rent - RPI Linked	🕮	🕮	🕮	✓	✓	🕮	🕮	🕮	×	🕮	🕮	✓	🕮	✓	🕮	🕮	✓	🕮	🕮	🕮	✓	✓	🕮
Is Service Charge factored within affordability?	✓	×	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	×	✓
Will lend against a leasehold flats?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Will lend against a leasehold houses?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Will lend against a flat in a commonhold development?	×	✓	×	✓	✓	×	✓	✓	✓	×	✓	✓	×	✓	×	✓	×	✓	×	×	✓	✓	×
What minimum unexpired lease term does the lender accept?	70 years from application	70 years from application	70 years from application	70 years from application	55 years subject to at least 30 years remaining at the end of the mortgage term.	Mortgage term plus 30 years.	55 years from completion, subject to at least 30 years remaining at the end of the mortgage term	Mortgage term plus 25 years	30 years remaining at the end of mortgage term.	70 years from completion	85 years from application.	85 years from completion	Mortgage term plus 30 years subject to an overall minimum term of 70 years	Either 50 years or mortgage term plus 25 years, whichever is the greater.	85 years from completion	85 years from completion	70 years at application and 30 years at the end of the mortgage term.	85 years from application.	Mortgage term plus 50 years at the start of the mortgage and at least 50 years at the end	75 years from application	85 years from application.	85 years from completion	50 years must remain at the end of the mortgage term

Key	
✓	Acceptable
×	Not Acceptable
🕮	Subject to lender criteria
%	Percentage cap
£	Monetary cap

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The Future

Industry forecasts predict gross lending to rise to £260bn in 2018, a key driver being increased remortgage activity.

Possible challenges facing the mortgage lending:

- Brexit
- Leasehold reforms
- Buy to Let tax changes

Our Sources

Our data was collected from:

UK Finance
Council of Mortgage Lenders Handbook (CML)
Knowledge Bank, lender criteria tool
Intermediary mortgage helpdesk(s)
LEASE-advice.org

Disclaimer

This presentation is intended for Long Harbour and their clients. It is not intended and does not constitute as financial advice.

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