



**Law
Commission**
Reforming the law



LEASEHOLD HOME OWNERSHIP: BUYING YOUR FREEHOLD OR EXTENDING YOUR LEASE

Report on options to reduce the price payable

Summary

No 387

Introduction

Leasehold enfranchisement is the process for people who own property on a long lease (“leaseholders”) to extend the lease, or buy the freehold. In order to exercise enfranchisement rights, leaseholders must pay a sum of money (“a premium”) to their landlord.

This paper summarises our “Report on options to reduce the price payable”, published on 9 January 2020 (“the Report”), and available at www.lawcom.gov.uk/project/leasehold-enfranchisement/. The Report concerns how premiums are calculated.

The Report follows our consultation on wide-ranging reforms to the enfranchisement regime. Our Consultation Paper is available at the same address.

Our Terms of Reference, agreed with Government, asked us:

“to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests” (emphasis added).



In accordance with our Terms of Reference, therefore, in the Report:

1. we set out options for reducing premiums and for simplifying the way in which premiums are calculated; but
2. we do not make a recommendation as to how premiums should be calculated. That is a not just a legal question: it involves considerations of law, valuation, social policy, and political judgement, and is therefore for Government and ultimately Parliament to decide.

The Report enables Government and Parliament to decide how premiums should be calculated, informed by the consultation responses that we received and by our own expertise and analysis.

In the Report, we set out three alternative options for a new regime to calculate premiums. Within each of those three schemes, there is a series of further sub-options for reform. In this Summary, we explain those three schemes, and the sub-options, for reform. At each stage, we explain which leaseholders would benefit from the reforms. A diagram representing the schemes and sub-options, and the relationship between them, is then provided at page 23.

Depending on which options for reform are pursued, it would be possible to create an online calculator for the calculation of premiums. Whilst valuation is complex, it does not have to be complex for the user. An online calculator would be simple for leaseholders to use, and would provide them with certainty about what their enfranchisement premium will be.

Valuation is a technical subject, but we have tried to make this Summary, and the Report, as accessible as possible. We have included a glossary at the end of this Summary.

Forthcoming Law Commission reports

We will shortly publish three further reports:

- a separate report addressing all other aspects of a reformed enfranchisement regime – such as who qualifies to make an enfranchisement claim and the process that they must follow to exercise their rights. In that report, we will make recommendations as to how the regime should be reformed.
- a report on our project on the right to manage, which is a right for leaseholders to take over the management of their building without buying the freehold. They can take control of services, repairs, maintenance, improvements, and insurance.
- a report on our project on commonhold, which allows for the freehold ownership of flats, offering an alternative way of owning property which avoids the shortcomings of leasehold ownership.

What is leasehold ownership?



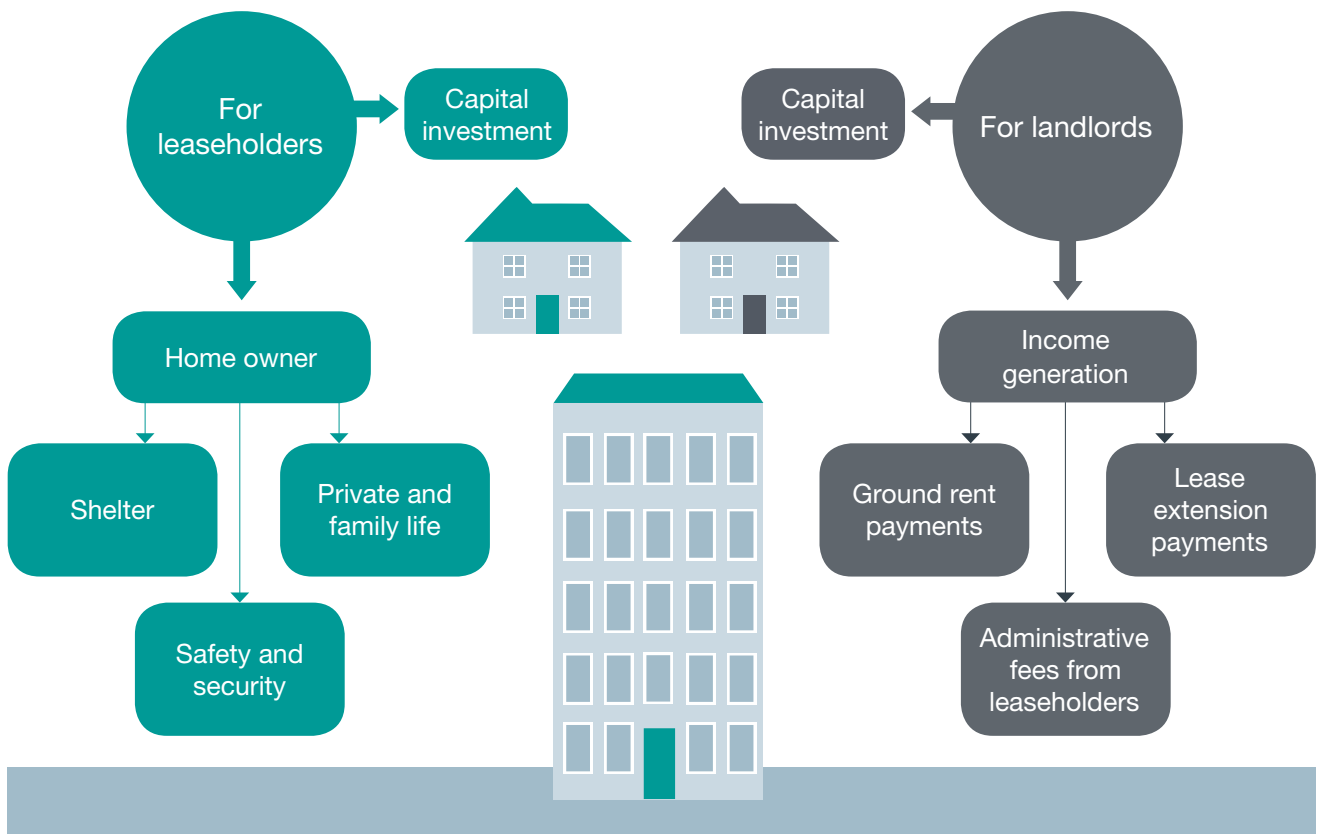
In England and Wales, property is currently almost always owned on either a freehold or a leasehold basis.

1. Freehold is ownership that lasts forever, and generally gives fairly extensive control of the property.
2. Leasehold provides time-limited ownership (for example, a 99-year lease), and control of the property is shared with, and limited by, the freehold owner (that is, the landlord).

Our project concerns leasehold ownership.



The purpose of a leasehold home



What are enfranchisement rights?

Legislation has been enacted that gives leaseholders “enfranchisement rights”.

Lease extension

Leaseholders have a right to extend their lease (“the right to a lease extension”), which provides them with longer-term security in their home. Leaseholders’ security in their home, and the value of their asset, is far better protected if, as the current law allows, they can extend, say, a 60-year lease to 150 years.

Freehold purchase

Leaseholders of houses have a right to purchase their freehold, and leaseholders of flats have a right, acting with the other leaseholders in their building, to purchase the freehold of their block. Freehold acquisition provides leaseholders with the same advantages as a lease extension (namely, security in their home and protecting the value of their asset), but also allows leaseholders to gain control of their property from an external landlord.

What are premiums? (see Chapter 2 of the Report)

The result of an enfranchisement claim is that the leaseholder acquires from the landlord an enhanced interest in their property. Put another way, an enfranchisement claim involves the transfer of a property right (a longer lease or the freehold) from the landlord to the leaseholder.

The landlord's entitlement under the lease, which is lost on enfranchisement, is valuable to the landlord. Equally, the enhanced interest acquired by the leaseholder through the enfranchisement claim is valuable to the leaseholder.

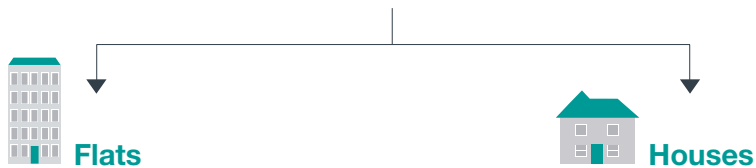
Leaseholders must make a payment to their landlord to reflect the value of the enhanced interest that they acquire from the landlord. We use the term "premium" to describe this payment, but it is sometimes also referred to as a "price" or "compensation".

An example: why must leaseholders pay a premium?

A leaseholder has 60 years remaining on his or her lease, and is required by the lease to pay the landlord a "ground rent" of £200 per year.

The landlord is entitled to have the property back in 60 years' time, and to receive the ground rent each year.

Result of an enfranchisement claim under the current law



The lease is extended by 90 years, so the landlord will not now be entitled to have the flat back for 150 years.

The ground rent is reduced to nothing, so the landlord will no longer be entitled to the ground rent of £200 per year for the next 60 years.

The leaseholder acquires the freehold, so the landlord will not now be entitled to have the house back at all and will no longer be entitled to the ground rent of £200 per year for the next 60 years.

Requirement to pay a premium

The landlord is no longer entitled to the property in 60 years, and is no longer entitled to the ground rent each year. The leaseholder must make a payment to the landlord to reflect the fact that the landlord's entitlements under the lease are reduced or removed.

Calculating the premium is known as “valuation” as it involves putting a financial value on the interest the landlord has that will be acquired by the leaseholder. Broadly speaking, enfranchisement premiums are intended to reflect the “market value” of the landlord’s asset – which we discuss further below. The market value is the amount that an asset is worth if sold in the open market.

There are two main bases of valuation:

1. The “mainstream valuation basis” is based on an assessment of the market value of the landlord’s interest. It applies to all flats and many houses.
2. The “original valuation basis” includes an assessment of the market value of the land on which the house is situated, but not the value of the house itself, and results in lower premiums for leaseholders. It applies to houses (not flats) which fall below certain financial limits.

We discuss the current law and the methods used to calculate premiums in Chapter 2 of the Report. We deal specifically with the original valuation basis in Chapter 9 of the Report.



Throughout the Report, we refer to a number of example enfranchisement claims. We use these examples to demonstrate how premiums are currently calculated under the “mainstream valuation basis”, as well as to show the impact that our options for reform may have on those premiums. In this Summary, we include just one of the examples from the Report (which we call House A in this Summary – and which is “House 2” in the Report): the purchase of the freehold of a house, worth £250,000 and with 76 years remaining on the lease.

House A

Value on a freehold basis: £250,000

Valuation date: 2019

Details of existing lease:	After freehold purchase:
Granted in 1995 for 100 years	No lease
Unexpired term: 76 years	No ground rent
Value of lease: £226,250	Value of freehold: £250,000
Ground rent: £50 a year, increasing by £50 every 25 years:	
– £50 per annum from 1995	
– £100 per annum from 2020	
– £150 per annum from 2045	
– £200 per annum from 2070	

The enfranchisement premium would comprise three elements:

1. the value of the right to receive the ground rent over the next 76 years, which is referred to as “the term” +
2. the value of the right to have the property back when the lease expires, which is referred to as “the reversion” +
3. half of the “marriage value”, which is an additional payment to reflect the fact that the value of owning the freehold outright is worth more than the sum of the freehold and leasehold interests in separate ownership. (We discuss marriage value, and the related concept of “hope value”, further below.)

The exact enfranchisement premium for House A would depend on various factors. In particular, each of the three elements of the premium is calculated by using certain “rates” which will vary from case to case. We have given indicative rates in our worked examples, and the result of using those rates is that the premium that the leaseholder would have to pay in order to acquire the freehold of House A is £16,453.

House A

The total premium is:
the term (£1,806)
+ the reversion (£7,349)
+ the payable share (50%) of marriage value (£7,298)
= **£16,453**

In Appendix 3 to the Report, we explain in detail how each element (the term, the reversion, and the payable share of marriage value) is calculated under the current valuation methodology.

We refer back to House A when we discuss our options for reform below.

What is “marriage value” and “hope value”?

The combined value of the leaseholder’s interest and the landlord’s interest in a property is often less than the value of those interests if they were held by the same person.



House A

In separate ownership

The leaseholder’s interest is worth £226,250.
The landlord’s interest (which is the value of “the term” and “the reversion”) is worth £9,155.

So in separate ownership, the lease and the freehold are worth a total of £235,405.

In single ownership

The freehold to House A is worth £250,000.
So if the lease and freehold were owned by the same person, they would be worth £250,000.

The difference between those two figures is the “marriage value”, here £14,595.

When the leaseholder acquires the freehold, that marriage value is “realised” or “released” because the leaseholder now owns a house worth £250,000.

Where the lease has 80 years or less to run, the legislation requires the leaseholder to pay half of the marriage value to the landlord. Where the lease has more than 80 years to run, the legislation states that the leaseholder does not have to pay any marriage value to the landlord.

“Hope value” is a deferred form of marriage value. If the freehold is sold to someone other than the leaseholder, marriage value will not be realised as a result of that sale. However, the purchaser might “hope” that they will sell the freehold to the leaseholder in the future, which will realise marriage value. The purchaser may therefore pay an additional amount now to reflect that future possibility. That additional amount is “hope value”.

Hope value is always less than marriage value. A purchaser would not pay the full marriage value because the marriage value may not in fact ever be realised (if the lease simply runs its course and expires) or the marriage value may not be realised for a long time.

An individual leaseholder never pays both marriage value and hope value; only one of these elements of the premium is ever relevant to calculating the premium in an enfranchisement claim.

Market value and the role of assumptions

Enfranchisement premiums under the “mainstream valuation basis” (and, to some extent, under the “original valuation basis”) are intended to reflect the “market value” of the landlord’s asset. The valuation of any asset, whether in the context of an enfranchisement claim or in any other context, involves various “assumptions” being made. Assumptions are made about the market in which the asset is being sold or about the nature of the asset that is being sold. For example, in the calculation of enfranchisement premiums, it is assumed that the leaseholder has complied with any repairing obligation in the lease – otherwise a leaseholder would benefit from a lower premium by allowing the property to get into a state of disrepair in breach of the repairing obligation.

Under the mainstream valuation basis, there is an assumption (which reflects the reality of the transaction) that the leaseholder is the purchaser of the asset. Since the leaseholder is the purchaser, the enfranchisement transaction will result in the marriage value being realised. The legislation therefore requires the marriage value to be split between the landlord and leaseholder (where the lease has 80 years or less to run) – so the leaseholder must pay half of the marriage value to the landlord. That split is based on the view that – in a negotiation – the landlord and leaseholder would agree to split the marriage value between themselves equally.

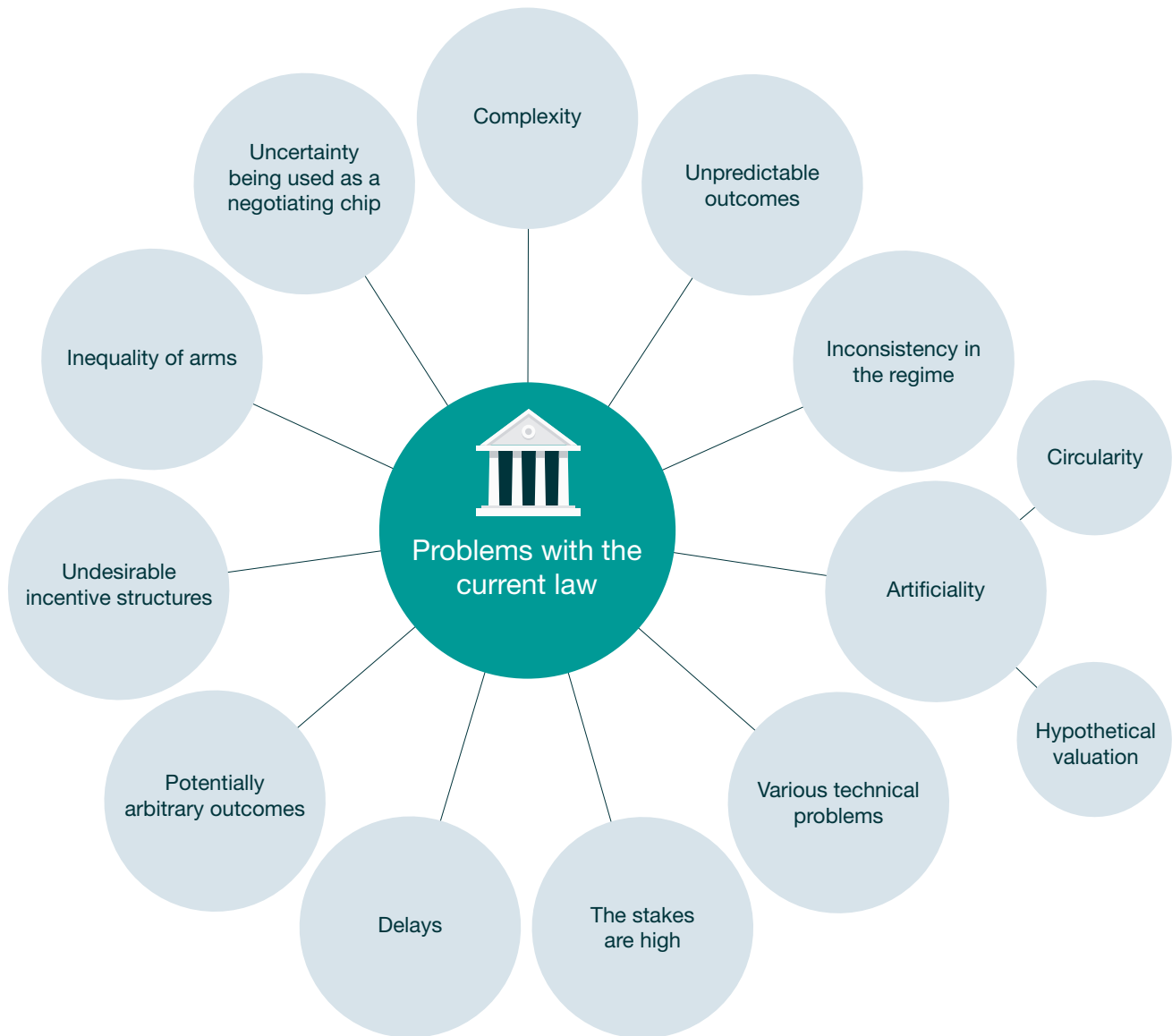
It is possible to make different hypothetical assumptions about the transaction being valued: for example, that the leaseholder is or is not the purchaser (known as “being in the market”) and/or that the leaseholder will or will not be in the market at some future time.

As we go on to explore below when discussing our options for reform, the assumption about the presence of the leaseholder in the market has a significant effect on the enfranchisement premium. It determines whether or not marriage value or hope value is payable.



PROBLEMS WITH THE CURRENT LAW

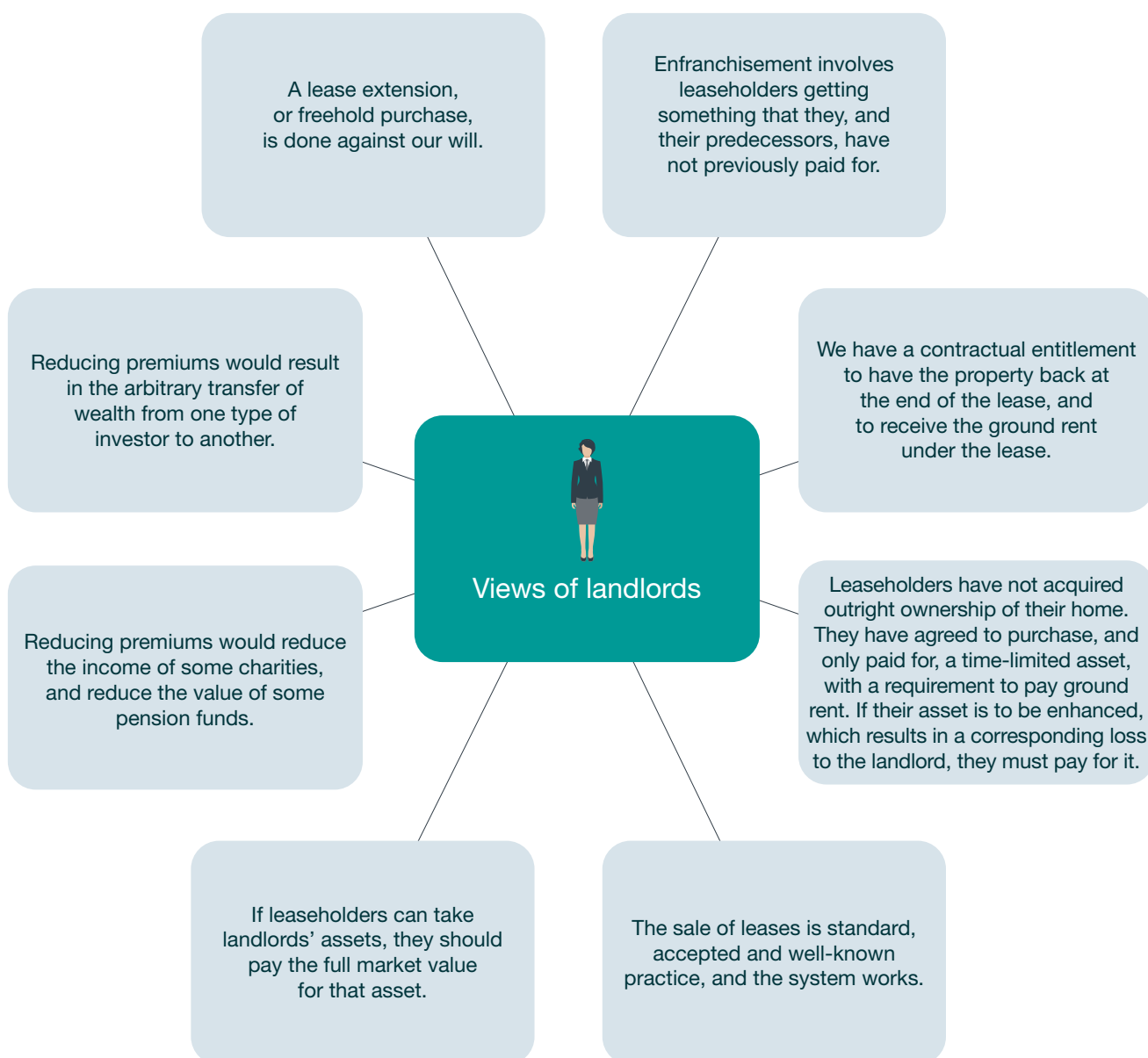
We explore various problems with the current law in Chapter 2 of the Report.

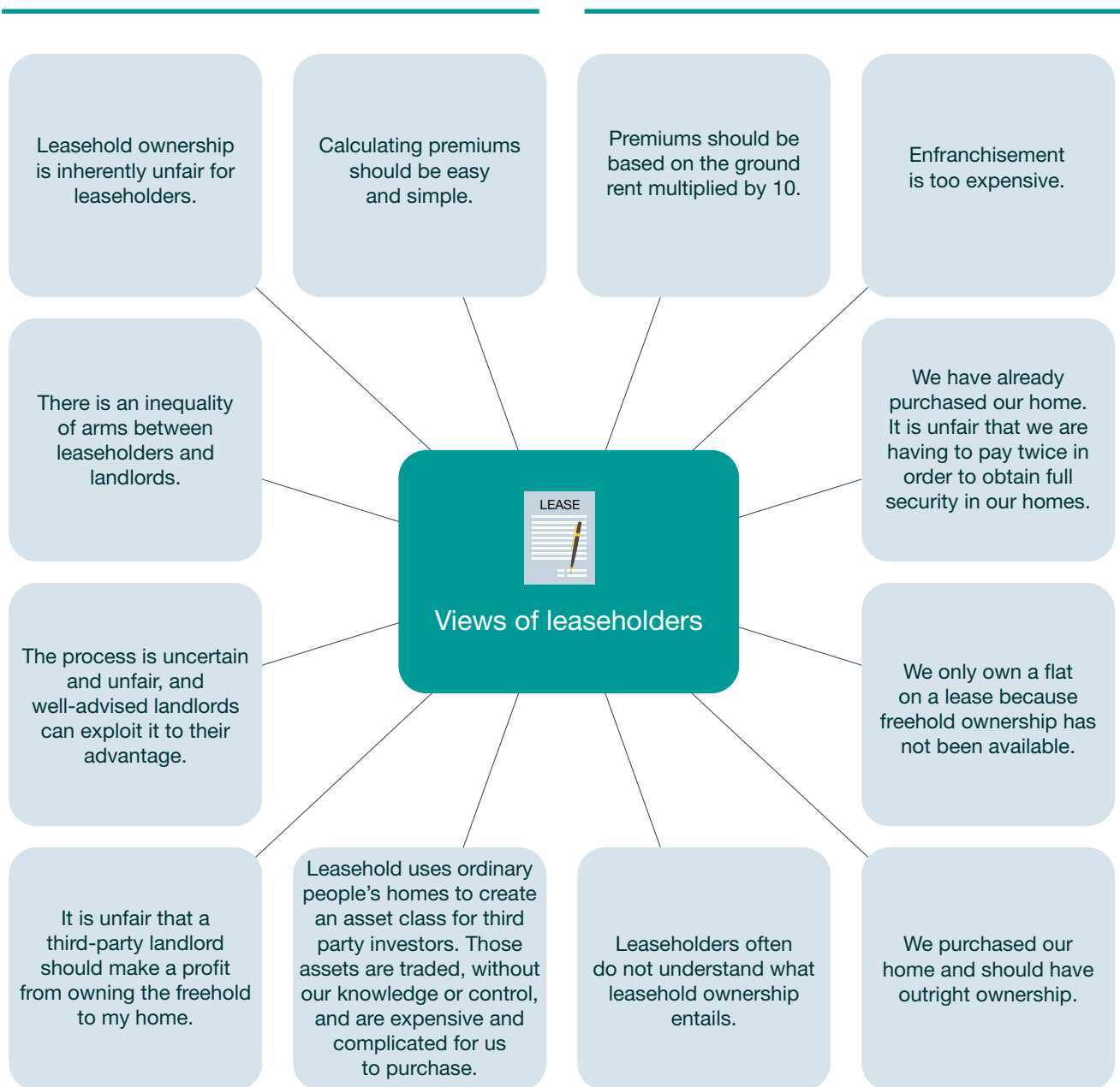


REDUCING PREMIUMS

Views on the fairness of enfranchisement premiums

During our project, we have heard opposing views from landlords and leaseholders about the fairness of the requirement to pay a premium in order to enfranchise, and the level of that premium. We summarise those views in the Report. Our Terms of Reference require us to examine the options to reduce premiums, and we take that as our starting point.





Sufficient compensation and human rights (see Chapter 1 of the Report)

The law governing human rights is highly relevant to valuation reform. Article 1 of the First Protocol (“A1P1”) to the European Convention on Human Rights (“ECHR”) provides for the peaceful enjoyment of property.

Article 1 of the First Protocol (“A1P1”) to the ECHR

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. ...

A1P1 and most other rights under the ECHR (“the Convention rights”) have been incorporated into English law by the Human Rights Act 1998 (“the 1998 Act”). The Convention rights therefore form part of English law, and any reforms to the enfranchisement regime that we set out, which Government seeks to implement, and which Parliament enacts, need to be compliant with the Convention rights.

The 1998 Act allows courts to declare that a provision of an Act of Parliament is incompatible with the Convention rights, and to award damages for any breach of Convention rights. In addition, a challenge can be brought in the European Court of Human Rights which can decide that there has been a breach of the Convention rights and which can make an award of compensation.

Accordingly, if legislation that reduces premiums is not compatible with the Convention rights, a challenge could be made and Government could be required to pay compensation to landlords whose rights have been infringed. The legislation is also likely to be amended in order to make it compatible with the Convention rights.



Our project, and the options for reform that we present, must therefore operate within human rights law. Some consultees asserted that any reduction in enfranchisement premiums would be unlawful under A1P1 and it is clear that any reforms will be carefully scrutinised. Given the necessity for a reformed valuation regime to be lawful under A1P1, we have obtained the independent opinion of Catherine Callaghan QC, a specialist human rights barrister, on the compliance with human rights law of our options for reducing premiums (which we refer to as “Counsel’s Opinion”). We have published Counsel’s

Opinion alongside the Report, and we quote Counsel’s Opinion throughout the Report.

Leaseholders’ human rights

During our consultation events, and in their consultation responses, leaseholders often asked us why we were focusing on landlords’ human rights, and what consideration was being given to their own human rights.

How are leaseholders’ human rights under the ECHR relevant? (Taken from Counsel’s Opinion)

It is important to bear in mind that leaseholders also enjoy rights that are protected under the ECHR. Leaseholders enjoy the right to the peaceful enjoyment of their possessions under A1P1.

Residential leaseholders who are owner-occupiers also benefit from the right to respect for their home under Article 8 [Article 8 provides that “Everyone has the right to respect for his private and family life, his home and his correspondence.”]

However, leasehold enfranchisement legislation does not interfere with leaseholders’ property rights under A1P1. Leaseholders’ interests are taken into account when determining the amount of compensation payable to landlords, as the exercise of assessing whether a fair balance has been struck necessarily entails balancing the interests of landlords against the interests of leaseholders, both in their own right and when considering the general interest of society.

Article 8 is not concerned with the right to own or occupy property as such. Article 8 is not engaged or violated either by the ordinary operation of a lease (which limits a leaseholder’s occupancy of the property to the term of the lease) or by requiring the leaseholder to pay for the extension of the lease or purchase the freehold to avoid that result.

The law is clear that leaseholders cannot rely on their human rights under A1P1 or Article 8 to challenge the ordinary operation of their lease, including the fact that they must make an enfranchisement claim, and that they must pay a premium to do so.

Landlords' human rights

As we set out above, our Terms of Reference require us to consider valuation options that ensure "sufficient compensation is paid to landlords to reflect their legitimate property interests". Views will invariably differ on what constitutes sufficient compensation. In legal terms, a central issue in determining whether compensation is "sufficient" is whether it is compatible with A1P1.

So landlords' human rights do not prevent leaseholders from buying their freeholds or extending their leases against the wishes of their landlord. But they do require leaseholders to pay for the freehold or lease extension in order to justify the interference with the landlord's property rights.

The enfranchisement premium that is paid by leaseholders to landlords is relevant when assessing the compatibility with A1P1 of any options for reform that would reduce those premiums.

How are landlords' human rights under A1P1 relevant? (Taken from Counsel's Opinion)

A1P1 protects the right to the peaceful enjoyment of possessions, and in substance guarantees the right of property. "Possessions" include real and immovable property, and therefore A1P1 protects any proprietary interest in land.

A1P1 can be invoked by any "natural or legal person" who has suffered an interference with their possessions for which the state is responsible, and can therefore be invoked not only by an individual but also by a company or other legal entity (whether based in the UK or elsewhere).

A1P1 is a qualified right. An interference with a person's property rights can be justified where a legitimate aim is pursued by reasonably proportionate means. This involves an assessment of whether a fair

balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's rights. The payment of compensation is relevant to the fairness of the balance struck.

Legislation which permits a leaseholder to compulsorily acquire the freehold or extend the lease of a house or flat interferes with a landlord's property rights under A1P1 and will only be lawful if the level of compensation payable to the landlord is sufficient to justify the interference with those property rights.

It is not necessary for landlords to be provided with full market value for their interest; there is some discretion within which property rights can be interfered with to achieve a legitimate aim. But generally the further away from market value the compensation is, the more difficult it is likely to be to justify the interference.

In the Report, we only put forward options for reform that are likely to be compatible with landlords' rights under A1P1. We have not, therefore, put forward options that are unlikely to be compatible with landlords' rights under A1P1. Our assessment of the compatibility of the options for reform that we put forward in the Report is based on Counsel's Opinion.

Our role (see Chapters 1 and 4 of the Report)

As we have explained above, our task is to set out the options that are available for reducing premiums payable by leaseholders. The question of whether and how premiums should be reduced is not solely a question of law: it involves considerations of law, valuation, social policy, and political judgement. It is a question for Government, and ultimately Parliament, to decide.



We have worked within our Terms of Reference to devise, consult on, analyse, and present the options for reform that exist, taking into account the views of consultees and working within the parameters of A1P1. The Report is the culmination of our work, setting out in detail the options for reducing premiums that are available, to allow Government and Parliament to decide which option(s) to pursue.

Implementing reform

Once Government has decided how valuation should be reformed, it will then be necessary to implement that reform by means of primary legislation (an Act of Parliament). A Bill will need to be prepared, which could create a new enfranchisement regime, covering both the valuation issues included in the Report and all other issues which will be included in our forthcoming report on enfranchisement reform.

CONSULTATION PERIOD AND EVENTS

On 20 September 2018, we published a Consultation Paper setting out our provisional proposals for wide-ranging reforms to the enfranchisement regime. We asked for views on valuation reform, and made proposals for reform designed to provide a new scheme of qualifying criteria for enfranchisement rights, to enhance and improve the enfranchisement rights themselves, and to provide a new unified procedure for all claims.

Following publication of our Consultation Paper, we held various public consultation events around England and Wales in order to explain our proposals for reform, encourage discussion and debate about our proposals, gather attendees' views and encourage people to provide written responses to the Consultation Paper. We also met with different groups of stakeholders to hear their views about reform.

In response to requests from consultees, we extended our consultation period to 7 January 2019. We received over 1,100 responses to our Consultation Paper and over 1,500 responses to our online survey about leaseholders' experiences of the enfranchisement process.

This Summary (and the Report) only concerns valuation reform. We will subsequently publish a separate report with our recommendations for reforming all other aspects of the enfranchisement regime.

We have published the consultation responses, in so far as they relate to valuation, alongside the Report. All other consultation responses will be published alongside our forthcoming separate report.

As explained above, there were many strongly-held views about leasehold reform, from leaseholders, landlords, professionals, and others. We have taken those views – expressed to us at consultation events and in written consultation responses – into account as we have developed the options for reform that we set out in the Report, and the recommendations for reform that we will set out in our forthcoming reports.



OUR OPTIONS FOR REFORM

Our Report sets out various options for reducing premiums and for improving the enfranchisement valuation process, such as increasing certainty or reducing delays.

Overall schemes: three options (see Chapter 5 of the Report)

In the Report, we set out three alternative options for a new regime to calculate premiums: Scheme 1, Scheme 2 and Scheme 3. They would set the general framework for the reformed enfranchisement valuation regime. As we go on to explain, within each of those schemes, there is a series of further sub-options for reform.

The enfranchisement premium under all three schemes would include an amount to reflect the value of “the term” and “the reversion”. The main difference between the three schemes is whether or not the premium includes marriage value or hope value.



We explain above the role of “assumptions” when calculating the market value of the landlord’s asset. The three schemes that we put forward reflect three different assumptions about the market in which the landlord’s interest is being valued. Those assumptions are about the presence of the leaseholder in the market, and they affect whether or not marriage value or hope value is payable.

Each scheme results in a premium that can be described as the “market value” of the landlord’s asset, by reference to that assumed market. It is what the landlord could expect to receive for his or her interest in that market.

Technical explanation of the schemes	Under Scheme 1, it is assumed that the leaseholder is never in the market. The result is that no marriage value or hope value is payable.	Under Scheme 2, it is assumed that the leaseholder is not now in the market but may be in the future. The result is that hope value (but not marriage value) is payable.	Under Scheme 3, it is assumed that the leaseholder is in the market. The result is that marriage value is payable.
What is the effect of the schemes?	Under Scheme 1, the enfranchisement premium would be: Term + Reversion	Under Scheme 2, the enfranchisement premium would be: Term + Reversion + Hope value	Under Scheme 3, the enfranchisement premium would be: Term + Reversion + Marriage value
How do the schemes compare with the current law?	Schemes 1 and 2 would reduce enfranchisement premiums. Scheme 3 reflects the current law. But all three schemes can be used as a framework for other reforms to reduce premiums (which we discuss below).		
Who would benefit from the schemes?	All leaseholders would benefit from the schemes if they are used as the framework to implement other reforms to reduce premiums (which we discuss below). Leaseholders with 80 years or less to run on their lease would also benefit directly from Scheme 1 or Scheme 2 since those schemes would lead to a reduction in their enfranchisement premiums by removing the requirement to pay marriage value.		

Scheme 1

Under Scheme 1, it is assumed that the leaseholder is not in the market at the time the premium is calculated and will never be in the market.

This assumption produces a premium based on the value of “the term” and “the reversion” only. The extra value attributable to the leaseholder being in the market (marriage value and hope value) is therefore not payable.

Scheme 1 reflects what the landlord would receive if the lease ran its course and the leaseholder never chose to extend the lease or acquire the freehold: the landlord would receive the ground rent (“the term”) and would get the property back at the expiry of the lease (“the reversion”).

Scheme 2

Under Scheme 2, it is assumed that the leaseholder is not in the market at the time the premium is calculated, but may be in the market in the future.

This assumption produces a premium based on the value of the term, the reversion, and (in certain cases) hope value. The extra value attributable to the leaseholder being in the market on the valuation date (marriage value) is therefore not payable.

Scheme 2 reflects what the landlord would receive if his or her interest were sold to a third party. An investor purchasing the freehold would not pay marriage value (because the leasehold and freehold interests would remain in separate ownership, so marriage value would not be realised). But an investor might pay hope value, to reflect the fact that he or she might in the future be able to realise the marriage value by selling the interest to the leaseholder.

Scheme 3

Under Scheme 3, it is assumed that the leaseholder is in the market at the time the premium is calculated.

This assumption produces a premium based on the value of the term, the reversion and marriage value (where it exists).

Scheme 3 reflects what the landlord would receive for his or her interest if sold to the leaseholder. By acquiring the landlord’s interest, the leaseholder realises the marriage value, and so would pay the landlord for it.

Scheme 3 reflects the way in which premiums are calculated under the current law, but when combined with other reforms Scheme 3 can still be used to reduce premiums.



Effect of the three schemes on the enfranchisement premium for House A

Details of existing lease				
Unexpired term	76 years			
Ground rent	£50 per year rising to £200 per year			
Value on freehold basis	£250,000			
Enfranchisement premiums				
Valuation under:	Current law	Scheme 1	Scheme 2	Scheme 3
Part (1): term	£1,806	£1,806	£1,806	£1,806
Part (2): reversion	£7,349	£7,349	£7,349	£7,349
Part (3): marriage / hope value	£7,298 (marriage value)	£- (no marriage value)	£1,460 (hope value)	£7,298 (marriage value)
Total premium	£16,453	£9,155	£10,615	£16,453

Within each of the overall schemes: seven sub-options (see Chapter 6 of the Report)

Within each of the three schemes, there is a series of further options for reform. These options could feature in any of the three overall schemes.

Reforms that would (or could) reduce premiums

Sub-option (1) Prescribing rates

We explain above the three main elements of an enfranchisement premium: “the term”, “the reversion” and “marriage value”. Each of those elements of the premium depends on a different “rate”.



The role of “rates” in calculating the premium

- To value “the term”, it is necessary to calculate a capital sum which reflects the right to receive the ground rent income in the future. A “*capitalisation rate*” is a rate of return which is used to calculate a capital sum that reflects the value of that income stream.
- To value “the reversion”, it is necessary to calculate a capital sum which reflects the value of the right to have the property back at the end of the lease. A “*deferment rate*” is used to discount the value of the freehold interest, to reflect the fact that instead of receiving the benefit of vacant possession of the property in the future, the landlord will receive money now.
- To assess “marriage value” and “hope value”, it is necessary to establish the relative value of the leasehold interest in a property compared to the freehold interest in the property. The percentage that is used in the valuation is called “*relativity*”.

Those rates will continue to have a role under each of the three overall schemes that we set out above. That is because enfranchisement premiums under each scheme would continue to include an amount to reflect “the term” and “the reversion”. The schemes differ in their treatment of marriage value and hope value, but under Schemes 2 and 3, the rate that is used to calculate those sums (“relativity”) would continue to be relevant.

Leaseholders and landlords (and their professional representatives) will frequently disagree on the appropriate rates in their case. The rates that are used, and therefore the enfranchisement premium, in any case depend on the outcome of negotiations between the landlord’s valuer and the leaseholder’s valuer or (if agreement cannot be reached) on the outcome of litigation between the parties. The rates that are used can have a significant impact on the enfranchisement premium.

Effect of different rates on the enfranchisement premium for House A

The enfranchisement premium of **£16,453** for House A is calculated using a capitalisation rate of 6%, a deferment rate of 4.75% and relativity of 90.5%.

If each of those rates are changed by 1% in favour of the leaseholder (to 7%, 5.75% and 91.5% respectively), the enfranchisement premium would reduce to **£13,166**.

If those rates were changed by 1% in favour of the landlord (to 5%, 3.75% and 89.5% respectively), the enfranchisement premium would increase to **£21,852**.

Leaseholders and landlords therefore face significant uncertainty about what the enfranchisement premium in any given case is likely to be.

In the Report, we conclude the enfranchisement process would be made more certain and predictable, simpler, more consistent, and cheaper if these rates were prescribed. The level of prescription could be at, or below, market value.

Benefits of prescribing rates (at any level)	<ul style="list-style-type: none"> Certainty and predictability Simplicity Consistency Removing unfair incentive structures Reduced scope for inequality of power, and litigation tactics, to influence the outcome Reducing costs, delays and litigation
Benefits of prescribing rates (below market levels)	All of the benefits listed above, plus leaseholders would pay lower enfranchisement premiums.
Who would benefit?	<p>Prescription at market rates would have benefits for all leaseholders and (in some cases) landlords.</p> <p>Prescription at below-market rates would benefit all leaseholders.</p>

Sub-option (2) Capping the treatment of ground rent

One of the three main elements of an enfranchisement premium is “the term”. Under each of the three schemes that we put forward, enfranchisement premiums would continue to include an amount to reflect the value of “the term”.

The value of “the term” depends on the level of the ground rent. The higher the ground rent, the higher the premium.

Some leases contain very high ground rents, or ground rents that will become very high in the future. Ground rents are generally considered to be onerous when they exceed 0.1% of the freehold value of the property.

Currently, the existence of an onerous ground rent makes it particularly important for leaseholders to be able to exercise their enfranchisement rights in order to escape from the liability, but the presence of the onerous ground rent makes the enfranchisement premium very high.

In the Report, we conclude that there could be a cap on the level of the ground rent that is taken into account when calculating the value of “the term”. That cap could be set at 0.1% of the freehold value of the property. In so far as the ground rent under a lease exceeds that cap, it would be ignored when calculating the enfranchisement premium.

This option for reform would benefit leaseholders whose leases contain an obligation to pay an onerous ground rent. The ground rent for House A is not onerous, so a cap would not affect the premium. But for other leaseholders, a cap would significantly reduce premiums. We give an example in the Report of a lease which includes an onerous ground rent (starting at £300 per annum and doubling every 10 years). A ground rent cap would reduce the enfranchisement premium from £79,425 under the current law to £6,253. (As with all of our examples, the precise figures would depend on the rates that are used in that case.)

Benefits of capping ground rent in the valuation calculation	Reducing premiums for leaseholders with onerous ground rents.
Who would benefit?	Leaseholders who currently have onerous ground rents or whose ground rents may or will in the future (following review) become onerous, regardless of the length of their lease.

Sub-option (3) Development value

In some enfranchisement claims, the premium may be increased in order to reflect the development potential of the land being acquired. Most enfranchisement claims by individual leaseholders (for a lease extension, or to acquire the freehold of their house) would not include development value. But a requirement to pay development value can arise in an enfranchisement claim by a group of leaseholders in a block of flats to purchase the freehold of that block; they may be required, for example, to pay an additional sum to reflect the value of building further floors of flats on top of the block. Development value is payable even if the leaseholders acquiring the freehold have no intention to carry out any development.

This additional value would continue to be payable under each of the three schemes that we set out above.

In the Report, we conclude that leaseholders could be given a power to decide to accept a restriction on future development of their block when they acquire the freehold. If they chose to accept that restriction, they would not have to pay the landlord any development value in the enfranchisement claim – so their enfranchisement premium would be reduced. If the leaseholders subsequently decided that they wanted to develop the block and therefore “realise” the development value, they could negotiate with the former landlord to release the restriction. They would, at that stage, have to make a payment to the former landlord in respect of the development value.



Benefits of restricting development	Premiums would be reduced at the time of the enfranchisement claim.
Who would benefit?	Leaseholders of flats acquiring the freehold of their block, as they would not be required to pay the landlord an additional sum to reflect the potential to develop their properties. Leaseholders and landlords, as disputes, negotiation and litigation about development value would be reduced.

Sub-option (4) Differential pricing for different types of leaseholder

Enfranchisement rights were originally introduced in order to benefit owner-occupiers, but have since been expanded to all leaseholders (including, for example, buy-to-let landlords and other investors).

It would be possible to reform the valuation regime so that owner-occupiers benefit from reduced premiums, but commercial investors do not. Such an approach might be one way to ensure compliance with landlords' human rights, since the aim of enabling

people to exercise enfranchisement rights in relation to their homes (rather than in relation to a financial investment) could justify a lower premium.

In the Report, we conclude that there are significant drawbacks to a regime that differentiates between different categories of leaseholders. But it would be possible. And if Government wishes to reduce premiums to a level that cannot be justified under A1P1 if it applies to all leaseholders, then it could be necessary for Government to create such a distinction.

Benefits of differential pricing	Owner-occupiers would benefit from a lower enfranchisement premium. The policy of reducing premiums for leaseholders may be easier to justify under A1P1.
Who would benefit?	Leaseholders who are owner-occupiers, regardless of the length of their lease.

Reforms that would only reduce premiums if adopted alongside other reforms

We set out three further sub-options for reform. By themselves, they would increase premiums for particular leaseholders – which would be contrary to our Terms of Reference. In accordance with our Terms of Reference, we only present them as options if they are pursued alongside other measures, so that the overall effect is to reduce premiums. The potential advantages of these three sub-options do not relate to the reduction of premiums, but other benefits such as simplifying the process or removing inconsistencies.

Sub-option (5) 80-year cut-off in respect of marriage value

Leaseholders must pay 50% of the marriage value if their lease has 80 years or less left to run. If the lease has more than 80 years left to run, they do not have to pay any marriage value.

Under Scheme 1, marriage value would not be payable in any event and so the 80-year cut off would become redundant. Under Schemes 2 and 3, marriage value or hope value would be payable, and there would still be a role for the 80-year cut-off.

If rates are prescribed, the time and expense of calculating marriage value would be reduced, and it would be possible to remove the 80-year cut off. But the result would be that leaseholders with more than 80 years left to run would have to pay marriage value or hope value.

We conclude that the 80-year cut-off should be retained, otherwise premiums would increase for leaseholders with more than 80 years unexpired. That conclusion is subject to the possibility of removing the 80-year cut-off in combination with other reforms that would have the overall effect of reducing premiums.

Benefits of removing the 80-year cut-off	For landlords, an arbitrary cut-off for the payment of marriage value would be removed. Distortion of the market would be avoided, and the artificial cliff edge faced by leaseholders approaching the 80-year point would be removed.
Who would benefit?	Landlords of leases with more than 80 years left to run, because removing the cut-off would increase premiums. Leaseholders would not benefit unless this option is combined with other measures that would have the overall effect of reducing premiums.

Sub-option (6) Discount for leaseholders' improvements

The freehold value of a property is relevant to the valuation of “the reversion” and “marriage value”. It therefore remains relevant under each of the three overall schemes that we set out above.

Any increase in the value of the property which is the result of an improvement carried out by the leaseholder can be discounted from the freehold value. The effect is to reduce the premium. But identifying relevant improvements, and the appropriate discount, can be the source of much dispute between the leaseholder and landlord, leading to professional and litigation costs.

In the Report, we conclude that the discount should be retained, otherwise premiums will be increased for some leaseholders. However, we conclude that the discount could be simplified, limited or even removed in order to reduce disputes if such a reform were combined with other reforms to reduce premiums overall.



Benefits of removing the discount for leaseholders' improvements	Simplification, reducing the potential for disputes.
Who would benefit?	Landlords, because the effect of the discount is always to reduce premiums. Landlords and leaseholders would no longer incur costs when there are disputes about leaseholders' improvements.

Sub-option (7) Discount for the risk of holding over

When a long lease comes to an end, the leaseholder often has statutory rights to remain in the property paying a rent to the landlord. It is known as a right to “hold over”.

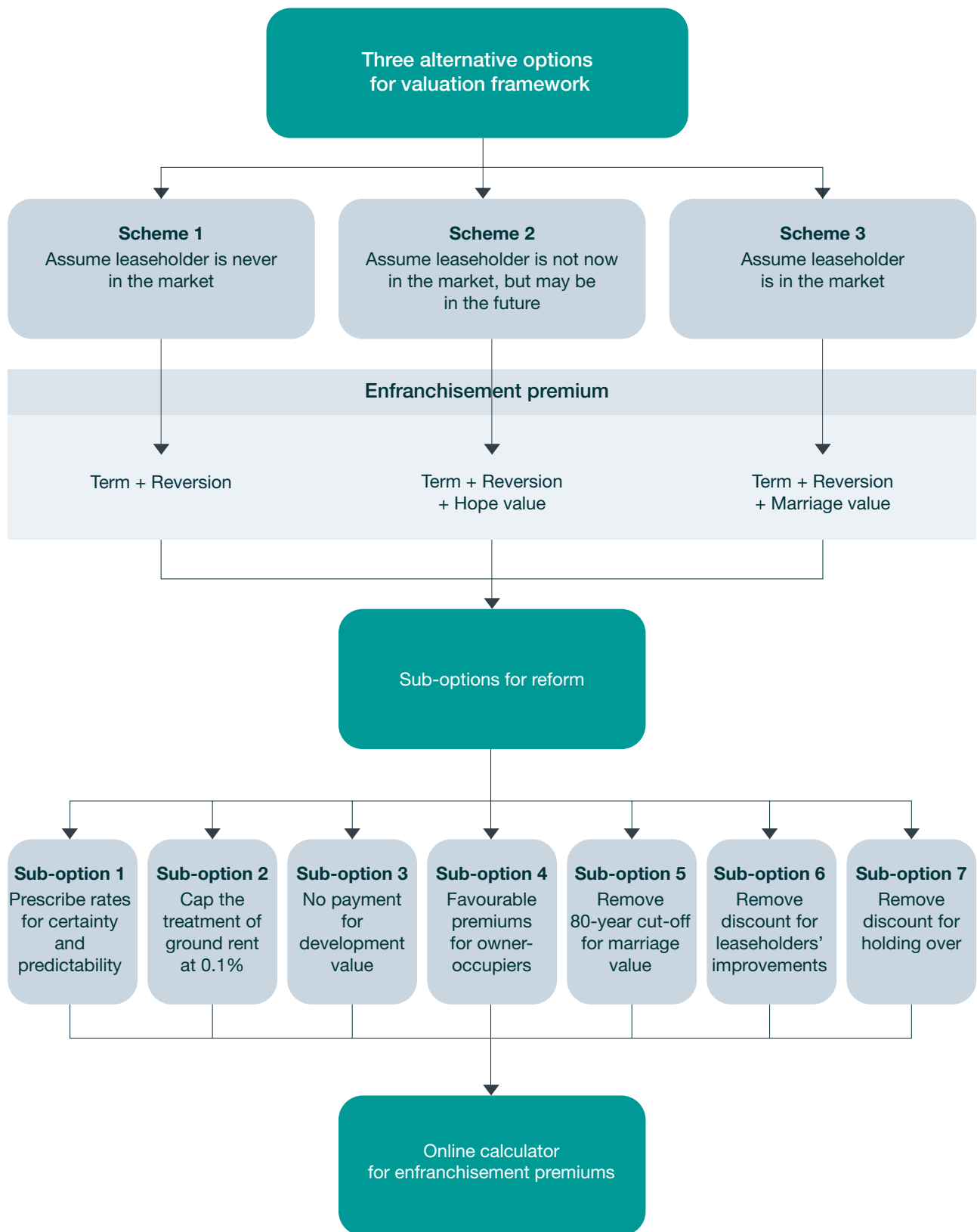
Similarly to the discount for leaseholders’ improvements, the right to hold over can reduce the value of the freehold, and therefore also reduce the enfranchisement premium. But the discount also creates some problems.

In the Report, we conclude that the discount for holding over should be retained, otherwise premiums will be increased for some leaseholders. However, we conclude that the discount could be removed, limited or prescribed in order to reduce disputes if such a reform were combined with other reforms that would reduce premiums overall.

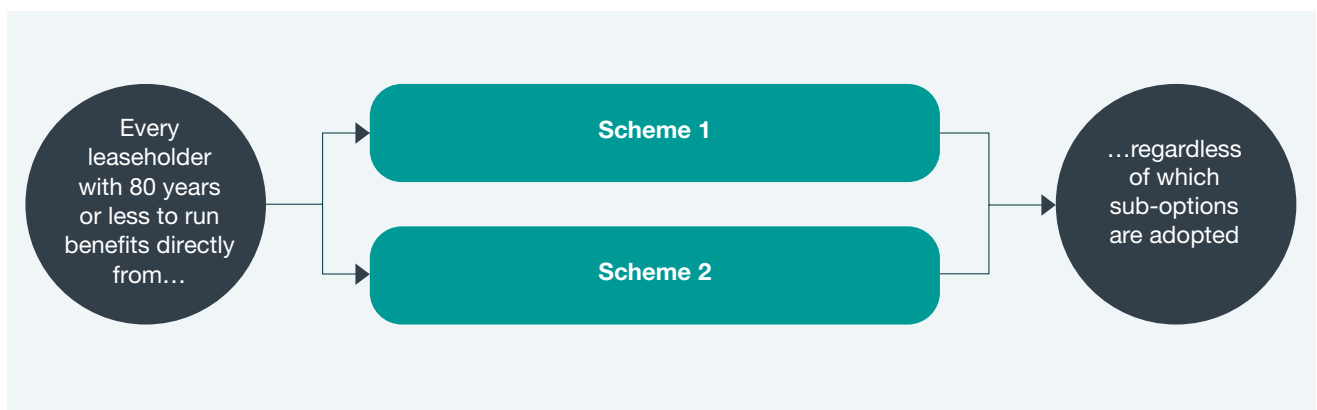
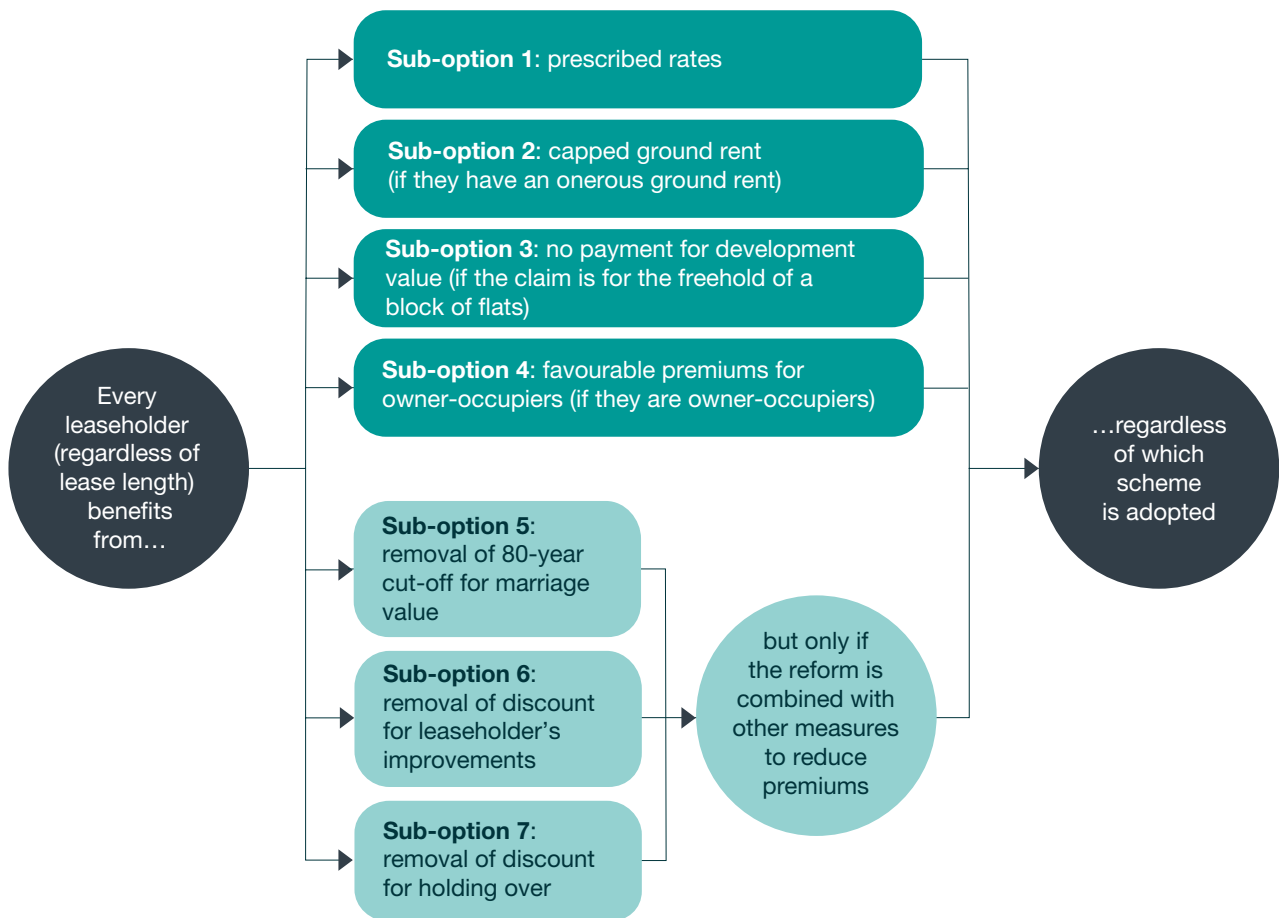
Benefits of removing the discount for the risk of holding over	Simplification, reducing the potential for disputes.
Who would benefit?	Landlords, because the effect of the discount is always to reduce premiums. Landlords and leaseholders would no longer incur costs when there are disputes about the discount for holding over.



Summary of options for reform



How would leaseholders benefit from the options set out in the Report?



**Working towards an online calculator
(See Chapter 7 of the Report)**



In Chapter 7 of the Report, we explore the possible role of an online calculator in a new enfranchisement valuation regime.

Whilst valuation is complex, it does not have to be complex for the user. It would be possible for an online calculator to be made available which could tell leaseholders and landlords – in certain circumstances – what the enfranchisement premium will be.

An online calculator would deliver significant benefits.

1. It would be simple to use.
2. It would increase certainty and predictability for the parties to an enfranchisement claim, so leaseholders and landlords would know where they stand.
3. It would remove the layers of complexity and inaccessibility which many consultees argued surround valuation.
4. It would significantly reduce the current scope for argument between the parties, consequential delays and associated professional costs.

Each of the three overall schemes that we put forward would accommodate an online calculator. But an online calculator could only be produced if rates are prescribed (see Sub-option 1 above).

<p>Benefits of an online calculator</p>	<p>Simplicity and accessibility Certainty and predictability Reduced professional costs Reduced scope for inequality of power, and litigation tactics, to influence the outcome Reduced disputes, costs and delays</p>
<p>Who would benefit?</p>	<p>Leaseholders (regardless of the length of their lease) and landlords.</p>



The role of a simple formula (see Chapter 6 of the Report)

In the Consultation Paper, we discussed the possibility of introducing a reformed valuation scheme which set enfranchisement premiums according to a simple formula, rather than by assessing the market value of the asset being acquired.

1. We discussed the regime in Scotland, which sets a formula which is based on a “capitalised ground rent”. That regime only applies to very long leases which have a low ground rent.
2. We discussed suggestions that had been made for the introduction of a “ground rent multiplier”, so that enfranchisement premiums could be calculated based on (say) ten times the ground rent.
3. We discussed the possibility of calculating enfranchisement premiums based on a percentage of the freehold value of the property.

These schemes could result in enfranchisement premiums reducing for all leaseholders, regardless of the remaining length of their leases.

The majority view of leaseholders responding to our consultation was that enfranchisement premiums should be based on the ground rent multiplied by 10. The views expressed by these leaseholders were strongly-held and unequivocal. Many leaseholders’ responses demonstrated their exasperation with the current regime, and their view that a simple formula of 10 times ground rent was an obvious and fair solution to many of the problems associated with calculating enfranchisement premiums.

If enfranchisement premiums were to be based on a ground rent multiplier in all cases, the regime would be very unlikely to be compatible with A1P1. We do not, therefore, put it forward as an option for reform in the Report.

Counsel advised as follows:

Under this valuation method, the only factor that would be used to determine the premium is the ground rent. The ground rent figure itself may be an arbitrary amount which bears no relation to the capital value of the property. This means that the resulting premium on enfranchisement would be arbitrary. The valuation method would take no account of the reversionary value (which may be substantial) or the length of the lease. Consequently, a premium based solely on the ground rent is likely to be arbitrary, bear no relation to the value of the landlord’s asset and be too inflexible to take account of differing situations. I consider that such a valuation method is unlikely to be compatible with A1P1, and I estimate the risk of a successful challenge to such a valuation method as High. It should be disregarded.

Similarly, if enfranchisement premiums were to be based on a percentage of freehold value in all cases, the regime would be very unlikely to be compatible with A1P1. We do not, therefore, put it forward as an option for reform in the Report.

Counsel advised as follows:

Under this valuation method, the premium would be set at a percentage of the capital value of the freehold. The premium would not reflect the length of the lease or any difference in the ground rent payable. It would therefore be equally as inflexible as a ground-rent multiplier. Depending on what percentage was set, it may result in higher premiums. I consider that such a valuation method is unlikely to be compatible with A1P1, and that the risk of a successful challenge to such a valuation method is High. It should also be disregarded.

Given the risk of a successful challenge on human rights grounds to either of these valuation approaches, we conclude that they should not be pursued as an option for reform in all enfranchisement claims.

In more detail: the problems with a simple formula if used in all cases

The problems with a ground rent multiplier, if used in all cases:

- a universal ground rent multiplier would not reflect the true value of “the term”. For example, a premium based on 10 times ground rent would be the same whether the lease had 10 years or 200 years unexpired, but the value of the right to receive an annual ground rent for 10 years is far less than the value of the right to receive that annual ground rent for 200 years.
- a universal ground rent multiplier would not reflect the true value of “the reversion” or marriage value, because the value of those elements of the premium depend on the length of the lease (not on the ground rent). The right to receive the property back in 200 years is far less than the value of the right to have the property back in 10 years.

In House A, the vast majority of the total enfranchisement premium of £16,453 comprises “the reversion” (£7,349) and the marriage value (£7,298). The value of “the term” (£1,806) is relatively low.

So a multiplier of ground rent, if applied in all cases, would not be reflective of the true value of the asset to the landlord. That is mainly because a ground rent multiplier takes no account of the length of the lease and it does not reflect the value of the reversion or marriage value.

The problems with a percentage of freehold value, if used in all cases:

- an enfranchisement premium based on freehold value would not reflect the value of “the term”, because the value of that element of the premium depends on the ground rent (not on the freehold value). If a lease has 100 years to run, a premium based on (say) 1% or 10% of the freehold value would be the same whether the ground rent was £5 or £500 per annum. But the right to receive £500 per annum is worth more than the right to receive £5 per annum.
- similarly, a percentage of capital value does not reflect the true value of “the reversion”. A premium based on (say) 1% or 10% of the freehold value would be the same whether the lease had 10 years or 200 years unexpired, but the value of the right to have the property back in 200 years is far less than the value of the right to have the property back in 10 years.

So a percentage of capital value, if applied in all cases, would not be reflective of the true value of the asset to the landlord. That is because it takes no account of the length of the lease or the level of the ground rent.

However, that is not to say that a simple formula has no potential role in a reformed valuation regime.

For a limited category of cases, a simple formula could be used either:

1. to implement one of the three overall schemes set out above; or
2. (in the event that there is no wholesale reform and Government rejects the three schemes set out above) as a stand-alone regime for straightforward and low-value enfranchisement claims.

In more detail: using a simple formula

A scheme similar to the Scottish legislation could be introduced. It could apply to leases which are similar to the leases to which that regime applies, namely very long leases (so the value of the reversion is minimal) and where the ground rent is fairly low and is not subject to review. Alternatively, a ground rent multiplier could be used for similar leases – very long leases (so the value of the reversion is minimal) where the ground rent is fairly low and not subject to review.

The main problem with such an approach is that many leases would not fall within the scheme. That is because there is a wide range of leases in England and Wales, including short leases (where the value of the reversion is high) and leases with high ground rents or complex review structures (where the value of the term is high). Consequently, the applicability and, therefore, benefit of such a scheme is likely to be limited.

Nevertheless, we put this approach forward as an option that Government might wish to consider, particular in light of the support and attention that simple formulae have attracted.

1) A simple formula as a mechanism to implement (in part) one of the three overall schemes

A scheme along these lines could be used to implement one of the three overall schemes set out above for a limited category of leases.

But doing so would add complexity to the law and would not produce any different results. That is because, if rates are prescribed and an online calculator is introduced, then the schemes that we put forward could be made as accessible and easy to apply as a regime based on the Scottish legislation or a ground rent multiplier. It does not therefore seem necessary if Government adopts a new overall scheme.

2) A simple formula as a stand-alone regime for straightforward and low-value claims

If the current valuation regime stays the same, there would still be scope for the introduction of a simple formula for a limited category of straightforward and low-value claims.

The “original valuation basis” (see Chapter 9 of the Report)

In Chapter 9, we discuss the “original valuation basis” of calculating the premium and set out the options for how that basis of valuation could be reformed.

The original valuation basis applies to some leaseholders of houses who are purchasing their freeholds, where the house falls under certain financial limits.

The responses to our consultation have suggested that it is still widely used, particularly in areas such as the Midlands and South Wales.

Valuations under the original valuation basis are attractive to leaseholders because they produce

a premium which is always significantly lower than a premium calculated under the mainstream valuation basis.

On the other hand, the original valuation basis gives rise to problems for leaseholders, as well as for landlords. There are problems both with the qualification criteria (working out which houses qualify for a valuation under the original valuation basis) and the valuation methodology (working out how to calculate the premium). These problems mean that the original valuation basis is outdated and difficult to use, which can increase costs for leaseholders and landlords, as well as increasing the risk of the premium being calculated incorrectly.

The main problems with the original valuation basis	
Qualification criteria	Valuation methodology
<p>Unworkable</p> <p>Whether a house qualifies under the original valuation basis can often depend on the house’s historic “rateable value” (a predecessor to council tax) which can be difficult or impossible to trace.</p>	<p>Too complex</p> <p>The way the premium is calculated under the original valuation basis is very difficult to understand and implement, especially for leaseholders.</p>
<p>Arbitrary</p> <p>The original valuation basis originally applied only to low value houses. Today, however, it no longer applies to all low value houses (some low value houses do not qualify for the more favourable valuation) or only low value houses (some high value houses qualify for the more favourable valuation).</p>	<p>Unfair on landlords</p> <p>Some people argue that the original valuation basis fails to compensate landlords properly when leaseholders purchase their freeholds. This is mainly because (in contrast to the mainstream valuation basis) a landlord is compensated primarily for the loss of the site, but not the loss of the building built on the site.</p>

In the Report we put forward two options for Government for reform of the original valuation basis:

1. **Retain the original valuation basis indefinitely and largely in its current form:** it could be retained as an exception to the mainstream valuation basis. Whilst this approach would not solve the problems set out above, it is the only way to ensure that all leaseholders who currently qualify under the original valuation basis would continue to benefit from this more favourable valuation (as opposed to having to pay a higher premium under the mainstream valuation basis). Prescribing rates would simplify the calculation and may even enable the use of an online calculator.

2. **Replace the original valuation basis with an entirely new scheme:** a more fundamental and far-reaching reform would be to replace the original valuation basis with an entirely new scheme designed accurately to identify (all and only) low value properties and provide them with a more favourable way of calculating premiums than higher value properties. A new scheme could apply to low value flats as well as houses, and so incorporate all low value homes. The new scheme would aim to be easier to understand and more suited to the realities of modern leasehold ownership than the original valuation basis. For example, leaseholders would not have to locate their rateable values to qualify for a valuation under the new scheme. The new scheme would also operate consistently to ensure that it includes all low value properties and excludes all higher value properties.

CONCLUSION

We have set out the options for wholesale reform of the valuation regime in order to reduce enfranchisement premiums for leaseholders whilst ensuring that landlords receive sufficient compensation. Landlords will oppose any reforms that would reduce premiums, and we expect that some leaseholders will say that the options that we set out do not go far enough. The options that we have set out are detailed and nuanced, and reflect the limitations of human rights law. It is now for Government to decide which of the options to pursue, and then for Parliament to pass an Act of Parliament to implement that reform.



GLOSSARY

A1P1: Article 1 of the First Protocol to the ECHR, which provides for the peaceful enjoyment of property.

Assumption: when assessing the market value of an asset, it is necessary to make “assumptions” about the market in which the asset is being sold or about the nature of the asset. For example, it is assumed that the leaseholder has complied with any repairing obligation in the lease.

Report: our “Report on options to reduce the price payable”, published on 9 January 2020, and available at <https://www.lawcom.gov.uk/project/leasehold-enfranchisement/>

Compensation: see “premium”.

Consultation Paper: our consultation paper “Leasehold home ownership: buying your freehold or extending your lease”, published on 20 September 2018, and available at <https://www.lawcom.gov.uk/project/leasehold-enfranchisement/>

ECHR: European Convention on Human Rights.

Enfranchisement rights: leaseholders have a statutory right to extend their lease. In addition, leaseholders of houses have a statutory right to purchase their freehold, and leaseholders of flats have a statutory right, acting with the other leaseholders in their building, to purchase the freehold of their block.

Freehold ownership: ownership that lasts forever, generally with fairly extensive control of the property.

Ground rent: a regular payment which a leaseholder is required by his or her lease to pay to the landlord.

Hope value: a deferred form of marriage value. If the freehold is sold to someone other than the leaseholder, marriage value will not be realised as a result of that sale. However, the purchaser might “hope” that they will sell the freehold to the leaseholder in the future, which will realise marriage value. The purchaser may therefore pay an additional amount now to reflect that future possibility.

Landlord: a person who owns an interest in property out of which a lease has been granted. A landlord may be either the freeholder of the property, or hold a leasehold interest in the property himself or herself.

Lease: the legal device (usually a written document) that grants a person a leasehold interest in a property and sets out the rights and responsibilities of the leaseholder and landlord.

Leasehold ownership: time-limited ownership (for example, a 99-year lease), and control of the property is shared with, and limited by, the freehold owner (that is, the landlord).

Leaseholder: a person who owns property on a long lease.

Market value: the amount that an asset is worth if sold in the open market.

Marriage value: the additional value that is gained when the landlord’s and leaseholder’s separate interests are “married” into single ownership. It is the difference between:

- (1) the value of the freehold in single ownership, and
- (2) the value of both (a) the freehold interest and (b) the leasehold interest in separate ownership.

The value of (1) is often more than (2). Marriage value is “realised” or “released” by an enfranchisement claim because the freehold and leasehold interests, previously in separate ownership, are now in single ownership.

Premium: the sum of money a leaseholder must pay in order to exercise enfranchisement rights. It can also be referred to as the “price” or “compensation”.

Price: see “premium”.

Reversion: we use “the reversion” to refer to the value of the right to have the property back when the lease expires.

Term: we use “the term” to refer to the value of the right to receive the ground rent for the duration of the lease.

Unexpired term: the remaining amount of time left until the end date specified in a lease. A lease granted for a period of 50 years will, after 10 years, have an unexpired term of 40 years.

Valuation: the process of calculating the premium by putting a financial value on the interest the landlord has that will be acquired by the leaseholder.

