



Department for
Communities and
Local Government

Rentcharges Act 1977

A technical discussion paper



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Department for Communities and Local Government
Fry Building
2 Marsham Street
London
SW1P 4DF
Telephone: 030 3444 0000

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Introduction

1. Rentcharges are an annual sum paid by the owner of freehold land (normally a house) to another person who has no other legal interest in the land. Rentcharges are common only in certain areas and traditionally provided a continuing income for landowners who allowed their land to be used for development. Sometimes the land was released without a capital sum being paid; with the Rentcharge being the only payment. Once it is imposed, a rentcharge continues to bind all the land even if it is later divided and sold off in plots.
2. Subject to limited exceptions, the Rentcharges Act 1977 prevents the creation of new Rentcharges and provides for all Rentcharges to be extinguished on 22 July 2037. The aim is to abolish the system, which has no practical purpose in modern property transactions. The delayed abolition is intended to avoid unfairly interfering with legitimate expectations of income.
3. The Rentcharges Act 1977 also provides procedures (section 8) to enable the payers of Rentcharges to apply to the Secretary of State to redeem the Rentcharge and (section 4) to apportion (legally separate) their share of a Rentcharge and ground rent (leasehold rents) that is payable on multiple properties. This paper is concerned only with the type of rentcharges that can be redeemed under section 8.
4. Since the coming into force of the Rentcharges Act 1977 the Government has been using the formula in section 10 of the Act to work out the redemption figure so that the rent payer can buy out ('redeem') their Rentcharge.
5. The algebraic formula applied to work out the redemption price uses the yield of the 2½% Consolidated Stock to calculate a lump sum that has the same value as the right to receive all the rent charges over the remainder of the term. The yield from this government stock gave a reasonable approximation of the yield that the rent owner might have expected to earn on the investment and thus how much the total value of the rentcharges over the period remaining might be worth to them.
6. A statutory formula along the same lines is used for calculating minor superior leasehold interests for enfranchisement under the Leasehold Reform Act 1967, and minor intermediate leasehold interests for lease renewals and enfranchisement under the Leasehold Reform, Housing and Urban Development Act 1993. These Acts provide no legislative means of updating the formula.
7. The formula was tried and tested, as it had already appeared in the Land Tenure Reform (Scotland) Act 1974 for dealing with feu duties, which were akin to Rentcharges.

The Issue

8. The 2½% Consolidated Stock used in the formula was redeemed by the Government on 5 July 2015, following the exercise of the embedded call option, announced by the Chancellor of the Exchequer at the Budget on 27 March 2015. As this Stock was undated, it is likely that the possibility of it being redeemed was not envisaged back in 1977. This is reflected in that the legislation specifically refers to it by name, and there is no provision for its replacement or substitution.
9. With the Stock no longer in existence, it is not possible to use the prescribed formula to calculate a settlement price without a legislative amendment to update the formula. Applications can only be processed (if valid) up to the point at which the calculation is required to be made and no further than this. As a result, until the legislation is changed, the Secretary of State is unable to issue a redemption certificate to an applicant and the land remains affected by the rentcharge.
10. Without a new option to replace the yield part in the formula it not possible for leaseholders to use the rights given to them for calculating minor superior leasehold interests for enfranchisement under the Leasehold Reform Act 1967, and minor intermediate leasehold interests for lease renewals and enfranchisement under the Leasehold Reform, Housing and Urban Development Act 1993.
11. This paper seeks comment on three principal issues:
 - A replacement rate or instrument for the 2½% Consolidated Stock, to be used in the calculation formula for rentcharge redemptions;
 - Calculating minor superior leasehold interests for enfranchisement and minor intermediate leasehold interests for lease renewals and enfranchisement;
 - The future role of the Secretary of State in the process of redeeming rentcharges.

The formulas

- The Rentcharges Act 1977 (section 10) (rentcharge redemption)

$$P = \pounds \frac{R}{Y} - \frac{R}{Y(1 + Y)^n}$$

P = the redemption price; R = the annual amount of the Rentcharge to be redeemed; Y = the yield, expressed as a decimal fraction, from 2.5%; Consolidated Stock; and n = the period, expressed in years (taking any part of a year as a whole year), for which the Rentcharge would remain payable if it were not redeemed in calculating the yield from 2½ per cent. Consolidated Stock = the price of that stock shall be taken to be the middle market price at the close of business on the last trading day in the week before that in which instructions for redemption are served under section 9(4) of the Rentcharges Act 1977.

- Leasehold Reform Act 1967 (para 7A(5) of Schedule 1) (enfranchisement or extension)

$$P = \pounds \frac{R}{Y} - \frac{R}{Y(1 + Y)^n}$$

P = the price payable; R = the profit rent; Y = the yield (expressed as a decimal fraction) from 2½ per cent. Consolidated Stock; [this has now been redeemed]; n = the period, expressed in years (taking any part of a year as a whole year) which the minor superior tenancy would have to run if it were not extinguished by enfranchisement.

In calculating the yield from 2½ per cent. Consolidated Stock, the price of that stock shall be taken to be the middle market price at the close of business on the last trading day in the week before the tenant gives notice in accordance with this Act of his desire to have the freehold.

- Leasehold Reform, Housing and Urban Development Act 1993 (paragraph 7(7) of Schedule 6 and paragraph 8(6) of Schedule 13) (collective enfranchisement and lease extension)

$$P = \pounds \frac{R}{Y} - \frac{R}{Y(1 + Y)^n}$$

P = the price payable; R = the profit rent; Y = the yield (expressed as a decimal fraction) from 2½ per cent. Consolidated Stock; [this has now been redeemed] n = the period, expressed in years (taking any part of a year as a whole year), of the remainder of the term of the minor intermediate lease as at the valuation date.

In calculating the yield from 2½ per cent. Consolidated Stock, the price of that stock shall be taken to be the middle market price at the close of business on the last trading day in the week before the relevant date¹.

12. We do not propose to change any of the formulae, only to replace the reference to the Stock used in the “Y” part of the formulae.

¹ As defined in section 1(8) of the Leasehold Reform, Housing and Urban Development Act 1993.

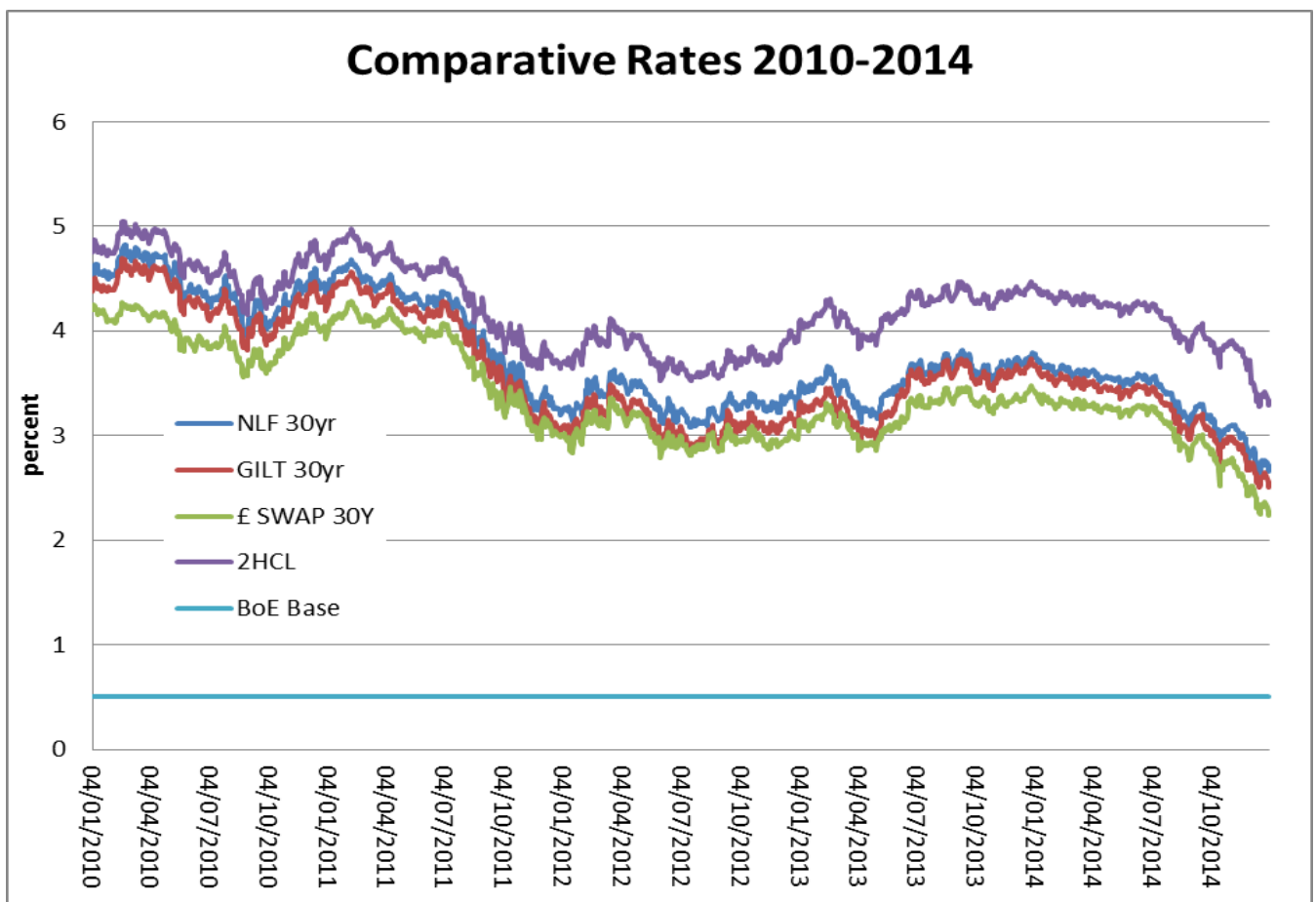
Replacing the redeemed Stock/providing a new rate or yield (Y) for the calculation

13. The key factors in selecting a replacement option are:
 - A simple and transparent means of identifying the rate of return or yield on a long-term low risk investment, similar to the 2½% Consolidated Stock
 - The 'figure' should be easy for the lay person to look up using published source(s)
 - There should be a clear single figure that does not leave room for dispute or challenge
 - It should continue to provide a balanced and fair settlement figure for all parties, so that they retain confidence in the process
 - Consistency is important because the 2½% Consolidated Stock that has been redeemed is also referenced in other Acts, notably the Leasehold Reform Act 1967 and the Leasehold Reform, Housing and Urban Development Act 1993.
14. With the assistance of the UK Debt Management Office (DMO) and the Debt and Reserves Management (DRM) team at HM Treasury, we have considered a number of possible alternatives that could be used in place of the redeemed Stock before selecting our preferred option:
 - 30-year National Loans Fund (NLF) rate, which is shown as a dark blue line on the graph below. NLF rates are, and will continue to be, calculated and published by the DMO on its website on a daily basis. These rates are calculated using a methodology specified by HM Treasury in accordance with section 5 of the National Loans Act 1968, and are already used in numerous other government contracts and loans. They are calculated using observable market-determined yields for individual gilts, from which a par yield curve is generated, smoothing out any rich or cheap characteristics of individual bonds, and allowing reference pricing for any chosen maturity date, within a 6-months bracket. In this case, we believe that the constant Maturity 30-30.5 year rate best represents the original intentions of all the legislation, and matches the global conventional definition of a long-dated benchmark.
15. The following other options were also considered:
 - a) A prescribed long-dated Gilt. There are no other undated/perpetual Gilts in existence. Nominating an existing fixed maturity Gilt might run the same risk of becoming illiquid or even cancelled/switched in later life. In any case, it would cease to represent a 'longer term investment' the closer it got to maturity date. Furthermore, the DMO has announced an intention to withdraw in due course from the publication of the daily end of day gilt

reference prices (which it publishes on behalf of the Gilt-edged Market Makers Association), and is currently helping to identify alternative ways that requirements for price provision could be met.

- b) A generic long-term Gilt rate (e.g. rolling 30- or 50-year maturity), shown as a red line on the graph below. Such a rate would represent a long term investment in UK Government bonds. They are currently published by some wire services providers (e.g. Bloomberg, Thomson Reuters) but are not widely available without relatively expensive subscription charges.
- c) Long-term sterling swap rates, shown as a green line on the graph below. These represent the fixed rates at which banks are prepared to lend to each other or to other financial market counterparties for a specified period. However, access to published data is likely to be subject to subscription fees.
- d) Shorter-term rates, such as the Bank of England's Base Rate, shown as a light blue line on the graph below. These are widely known and freely available but do not necessarily represent longer term returns.

16. The graph has been provided by the DMO and enables us to compare the yield of the NLF rate, which is our preferred option, between 2010 and 2014 against other options that were considered. It also includes the yield of the 2½% Consolidated Stock (2HCL) during this time, which was previously used in the redemption formula and shown as a purple line below.



17. To avoid the possibility of similar issues recurring in the event that the NLF rates cease or fail to be produced for any reason in the future, we propose to use an appropriate legislative mechanism to allow for the replacement option or any other aspect of the formula to be updated in legislation at any time.

Q1. Do you agree with the Government's preferred option of the 30 year National Loan Funds to replace the now redeemed 2½% consolidated stock in the calculation of:

- **The price payable on the statutory redemption of a Rentcharge (if your interest in this paper relates to rentcharges)**
- **The price or valuation of a minor intermediate leasehold interest in relation to leasehold enfranchisement or lease extension under Leasehold Reform Act 1967 and the Leasehold Reform, Housing and Urban Development Act 1993 (if your interest in this paper lies in these matters)**

If not please set out why.

Role of the Secretary of State in the redemption of Rentcharges

18. Under the Rentcharges Act 1977 the payers of rentcharges can apply to the Secretary of State to redeem (buy out) the rentcharge and to apportion (legally separate) their share of a rentcharge and ground rent (leasehold rents) that is payable on multiple properties.
19. Rentcharge payers have been able to use the service provided by Government at no cost to them or the rent owner.
20. In the period between January 2010 and December 2014, 1,705 applications were submitted - an average of 341 per year.
21. The Government does not believe that it is appropriate for it to continue to have a role in the redemption of rentcharges. This is essentially a private contractual matter between two parties and the costs associated with the ongoing provision of this service by the Government cannot be justified when compared with the amounts being paid for the actual redemption. The recent average price paid for redemption was £156.
22. We considered the possibility of charging for this service but concluded that, to recover the costs of providing this service, any charge would need to be over £300 - twice the recent average redemption figure. Furthermore the price paid by the rent owner for redemption is likely to reduce every year as we approach July 2037 when income supporting Rentcharges will be extinguished. We therefore decided that the Government should cease providing this service.
23. However, before we withdraw from providing this service we will continue to process cases submitted before the gilt was redeemed, as well as giving people a limited (3 months) period in which to apply for the final time to the Secretary of State for a redemption certificate. After this period no new applications will be accepted by the Government.
24. Given that the sums payable are low, we expect most rent owners and rent payers between themselves to reach a settlement on the price payable to redeem a rentcharge, taking advice as necessary.
25. Parties seeking to redeem a charge on an informal basis will usually take steps along the following lines:
 - The rent payer goes directly to the rent owner and asks them to agree to redemption of the rentcharge.
 - A redemption figure is agreed by both sides
 - The rent payer pays the redemption price to the rent owner

- The rent owner's legal representatives will then produce a 'deed of release' releasing the land from the rentcharge
 - The rent payer pays the rent owner's legal costs
 - The rent payer then sends a copy of the deed of release to the Land Registry who may agree to remove details of the rentcharge from the register (subject to having evidence of the rent owner's legal entitlement to the charge).
26. However we accept that a private agreement may not always be possible. To deal with this situation, we propose to:
- Continue to provide rent payers with a statutory right to redeem a rentcharge. This would be without applications being made to the Secretary of State.
 - Provide guidance on this right on the Gov.uk website. This step-by-step guidance will include information about how to calculate the redemption price and have a number of template documents for use.
27. While the Government considers the various options to remove its role from the redemption it wants to make clear that it will in the interim retain the existing function of carrying out apportionments on Rentcharges and ground rents where they are needed.

Q2. Do you agree:

- (i) That rent payers should continue to have a statutory right to redeem a rentcharge?**
- (ii) That a rent payer should no longer have the ability to make the application to the Secretary of State and that the Secretary of State should have no involvement in the redemption process apart from providing the formula and advice on Gov.uk?**

Q3. If the Secretary of State's role in the process is removed we propose providing advice on redemption on Gov.uk

- (i) Is there any particular issue that the above advice should cover?**
- (ii) What templates should be available?**

We would welcome reasons for your responses along with any other comments you may have.

How and when to respond

Please send your response to the questions in this technical discussion paper to:
Rentchargesconsultation@communities.gsi.gov.uk by 4 November 2015.