CMA
Competition & Markets Authority

# Leasehold housing

## Update report

28 February 2020
CMA115

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# Executive summary

1. This update from the Competition and Markets Authority (CMA) outlines its current thinking in its investigation into whether there have been breaches of consumer protection law in the leasehold housing market. It identifies a number of areas of significant concern where the CMA proposes to take enforcement action to address harm suffered by a number of homeowners. The update also outlines important areas where the CMA considers that the law needs to change in order to prevent harm to the public in the future.

2. The CMA launched its investigation on 11 June 2019 following concerns expressed by MPs (including the Secretary of State for Housing, Communities and Local Government) by members of the public and campaign groups. Concerns identified by MPs included those set out by the Housing, Communities and Local Government Committee (HCLGC) in its report, 'Leasehold Reform', published on 19 March 2019.[1]

3. The focus of the CMA's investigation has been whether there have been breaches of consumer protection law. We stated on 11 June 2019 that we were examining potentially unfair contract terms in leases, as well as broader allegations of mis-selling of leasehold property.

4. The CMA has now concluded the initial phase of its investigation, described in more detail below, and has identified a number of serious concerns.

5. The CMA's concerns fall into six main areas:

   *(a)* ground rent: in particular lease terms under which ground rents, which may initially be high, increase significantly over time. The amount of such increases is frequently unclear or uncertain. The consequences of such obligations can be severe for homeowners, creating difficulty in selling or mortgaging their homes;

   *(b)* ground rent: high or escalating ground rents that either mean that a tenancy is, or raise the prospect of a lease becoming, an 'assured

[1] Among other things, the Committee recommended in its report that the CMA investigate mis-selling in the leasehold sector.

tenancy' under the Housing Act 1988[2]. Despite its name, leaseholders whose tenancies become assured tenancies have diminished security of tenure making this a 'tenancy trap';

*(c)* ground rent: we have significant reservations about Retail Price Index (RPI) linked increases to ground rent;

*(d)* sales practices in relation to leasehold houses: we have received numerous complaints about some developers mis-selling leasehold houses. Many of the matters complained of are said to have influenced the behaviour of purchasers early in the sales process when they are deciding whether to go forward with the purchase of a home;

*(e)* permission fees and service charges: we have received numerous complaints that landlords or their managing agents charge high amounts in connection with any request made by a leaseholder (for example to make improvements to their homes) regardless of whether there is any contractual basis to do so;

*(f)* checks and balances: we are concerned that checks and balances that ought to have protected homeowners from potentially harmful terms and practices are not effective.

6. At this juncture the CMA is still carrying out its investigation. The thinking outlined in this update is not therefore the CMA's final position on the issues of concern. However the CMA considers that the issues it has identified have caused, and will continue to cause, significant harm to leasehold homeowners. It is in light of this harm that the CMA is preparing to take enforcement action to address mis-selling and problems faced by homeowners from high and increasing ground rents. We will also publish information to assist homeowners to understand their rights.

7. Action by the CMA can only partially address the concerns we have identified. The government is taking forward a number of policy and legislative initiatives that aim to improve outcomes for leaseholders. This includes legislation that will effectively abolish ground rents in future leases.

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[2] Where ground rents exceed £250 per year or £1,000 per year in London, a leaseholder is classed as an assured tenant. This means, for even small sums of arrears, leaseholders can be subject to a mandatory possession order under the Housing Act 1988.

8. The CMA strongly supports these measures. It also recommends that government:

   *(a)* reforms the system of redress for leaseholders, to make it simpler and less costly for them to contest permission fees and service charges they think are unreasonable or excessive;

   *(b)* legislates to address the assured tenancy 'trap', whereby leaseholders paying ground rents in excess of £250 per year (£1,000 per year in London) risk having their home repossessed for non-payment of ground rent. This risk not only reduces leaseholders' security of tenure, it also negatively affects the mortgageability of a property, and hence its saleability and market value;

   *(c)* improves the quality of information available to consumers early on in the buying process, including about the tenure of the property they are interested in, and the annual cost of ownership.

9. We set out below further detail of these recommendations, and other specific proposals that we consider can address the failure of the existing checks and balances within the leasehold housing market. We stand ready to support the Ministry of Housing, Communities and Local Government (MHCLG) and other government departments in taking forward these recommendations, and more broadly, as they develop policy and legislation to improve outcomes for leaseholders.

# Main report

1. In this update we summarise our current thinking and next steps in the CMA's investigation into the leasehold housing market.

2. The structure of the update report is as follows:

   *(a)* At paragraphs 3 to 12 we provide an overview of the CMA's current thinking in relation to ground rent, mis-selling, permission fees and service charges, and checks and balances.

   *(b)* At paragraphs 13 to 19 we set out the CMA's investigation to date.

   *(c)* At paragraphs 20 to 32 we provide some background to the leasehold market, including data to explain the size of the leasehold market and the prevalence of new-build long leasehold homes between 2000 and 2018.

   *(d)* At paragraphs 33 to 93 we describe the difficulties consumers have faced in their journey to, and after, the purchase of a leasehold home as well, in the paragraphs identified in (i) and (ii) below, as some of the market dynamics that bear on their experience.

      (i) At paragraphs 54 to 81 we provide greater detail on issues surrounding ground rent.

      (ii) At paragraphs 81 to 92 we provide greater detail on permission fees and service charges.

   *(e)* At paragraphs 93 to 99 we set out next steps for the investigation.

## Summary of the CMA's view

### *Ground rent*

3. In what has been termed 'modern leasehold' housing[3] ground rent is not legally necessary for there to be a valid lease. Nor have we seen persuasive evidence that it is commercially necessary. Despite this, many leases require homeowners to pay significant amounts of ground rent, that may increase substantially, where the amount of the increase is frequently unclear or uncertain. The consequences of ground rent obligations can be

[3] See further below at paragraph 53, but essentially properties subject to substantial and increasing ground rents that emerged after 2000.

severe for homeowners creating difficulty in selling or mortgaging their homes, but the justifications for it given to us seem at best limited.

4. Ground rents that double more frequently than every 20 years, and escalating ground rents that raise the prospect of a lease becoming an assured tenancy with the leaseholder consequently enjoying diminished security of tenure are likely to have the worst consequences for consumers. We also have significant reservations about RPI based increases to ground rent. Moreover, lease provisions imposing ground rent and providing for its escalation can be obscure and hard to understand.

5. We estimate that the total number of new-build long leasehold homes sold between 2000 and 2018 is approximately 778,000. On a conservative approach we think the total number of leases with ground rents that double more frequently than every 20 years is approximately 13,000, of which there are around 10,000 which double every 10 years. There are at least 57,000 homes where levels of ground rent are already over the threshold for an assured tenancy.

6. The most comprehensive way to tackle problems in ground rent is through legislation, and we support the government's proposal effectively to abolish ground rent in most future leases. However while this will prevent problems arising in future it will not alleviate existing problems. The CMA is preparing to take enforcement action to address the difficulties faced by homeowners from high and increasing ground rents.

7. The problem of assured tenancies is both very serious and one that can also be dealt with through legislation. We would support amendments to the Housing Act 1988 to provide homeowners with leases that are longer than 21 years with greater protection[4]. One approach would be to remove such leases from the scope of the Act completely. Alternatively, leases of more than 21 years could be excepted from provisions of the Act that are inconsistent with long term home ownership such as Grounds 7, 7A, 7B and 8 of Schedule 2.

### *Mis-selling*

8. We have received numerous complaints about the mis-selling of leasehold properties. Many of the complaints raise very serious concerns that

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[4] We recognise that there may be concerns about shared ownership leases that will bear on the solution finally adopted.

appear to have influenced the behaviour of purchasers at an important stage in the sales process: when they are in discussions with developers' sales staff and thus at the point at which they are deciding whether to go forward with the purchase of a home. Further details of the types of complaints we have seen are at paragraph 44 below. The CMA is preparing to take enforcement action to address mis-selling.

### *Permission fees and service charges*

9. We have also received numerous complaints about permission fees and service charges (as well as other charges connected with leases). We propose to publish information to assist homeowners to understand their rights and may in due course take further action if we are satisfied that to do so would be beneficial. We also propose to work with the government to see whether further protection for consumers can be developed. It is a real concern that homeowners who have entered into a lease are captive consumers with very little influence over the costs incurred by landlords or their managing agents that will in due course be passed on to them.

10. We also consider that the system of redress could be reformed to make it easier for consumers to contest permission fees and service charges they think are unreasonable. We would like to work with MHCLG and stakeholders to consider how the system can be reformed. Homeowners could well benefit from a simpler and quicker system of redress that would better enable them to practise self-help by challenging bills that are too high. Liability for costs incurred in challenging fees and charges could then reflect the purpose of the redress mechanism which would be to promote transparency in the dealings between landlords, their managing agents and consumers, provide incentives not to overcharge, and facilitate consumers' ability to challenge fees and charges.

### *Checks and balances*

11. We are concerned that checks and balances that ought to have operated to draw attention to changes in ground rent and their consequences did not prevent problems arising. While the negative consequences of these practices are unlikely to have been foreseen by individual consumers the same cannot be said for companies selling leasehold properties. The CMA is concerned that the executive and non-executive directors of several house-builders did not steer their organisations away from such practices, which have had, if nothing else, adverse reputational consequences for them, and which in turn raises concerns about the adequacy of their governance arrangements.

12. In the course of their acquisition of long leaseholds most homeowners will have taken legal advice and we are still considering the way in which legal advice was provided. However, a solicitor's role is not normally to advise on the merits of the purchase.[5] Conveyancing is one part of the overall process by which a consumer chooses and then purchases a flat or house. The decision whether to purchase is for the consumer, and a key check and balance in a well-functioning market flows from the decisions of well-informed consumers, able to make choices that are in their interests. Prospective buyers therefore need to be in a better position to make choices, particularly early in the process, than they are at present. We will work with government and stakeholders on ways to address this problem. One approach would be that whenever a house or flat is marketed for sale there should be a clear statement of:

    *(a)* the form of tenure and where the property is leasehold of the residual term of the lease;

    *(b)* the purchase price and an estimate of the costs of purchase; and

    *(c)* an estimate of the annual costs of owning that home to assist the purchaser to understand their future obligations.

## The CMA's investigation to date

13. The CMA opened its investigation on 11 June 2019 stating on its website 'The CMA is concerned about potential leasehold mis-selling, and whether leasehold contract terms are onerous and unfair in relation to ground rent, permission and other charges.' Those are the matters the CMA has investigated to date focusing on (i) potential mis-selling of new-build long leasehold houses since 2000, and (ii) potentially unfair terms relating to ground rents, service charges and permission fees in leasehold home-ownership in flats and houses.

14. The Secretary of State for Housing, Communities and Local Government, a number of MPs, and members of the public have expressed concerns about freehold mis-selling – so called 'fleecehold'. This is a separate issue from those presently under investigation as our current focus is on issues in leasehold home ownership. As the CMA's Chairman, Lord Tyrie, has said, the CMA will in due course consider whether to investigate freehold mis-selling, assessing the matter against its prioritisation principles.

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[5] In addition, the fact that a consumer has received legal advice does not mean that consumer protection law will not apply.

However we wish to complete our work in leasehold first and anticipate that doing so will assist us should we open a case on freehold mis-selling

15. During the course of the investigation the CMA has been concerned that its work should dovetail with that of other public bodies considering aspects of property law reform and has been in close contact with MHCLG in particular as well as representatives of local and national Trading Standards who have investigated allegations of mis-selling. Cardiff City Council were generous with their time in helping us to understand their recent litigation against Persimmon.

16. In order to consider whether, and how best, to carry out enforcement action we have used our statutory investigatory powers to obtain a substantial amount of information from major property developers and important investors in freeholds. We have also gathered information from leading mortgage lenders, to better understand the consequences of the practices we are concerned about. Four substantial information requests have been issued to a number of property developers, mortgage lenders and investors in freeholds. We have held meetings with almost all of those who provided information, as well as with important stakeholders such as the All Party Parliamentary Group on Leasehold and Commonhold and the National Leasehold Campaign. On 28 September 2019 members of the CMA's case team travelled to Liverpool to meet constituents of Maria Eagle MP to hear their concerns about their experience buying leasehold property.

17. We have also received significant numbers of emails and letters from consumers since we opened the investigation.

18. We have had constructive meetings with the Law Commission, Solicitors Regulation Authority, Law Society, Financial Conduct Authority, and Royal Institution of Chartered Surveyors, as well as the Land Registry and Office for National Statistics.

19. We have not carried out a market study or market investigation into the leasehold market. Rather, our investigation and the powers we have exercised have been directed to enabling us to understand whether to take enforcement action for infringements of consumer protection law. While we have gathered a lot of information about market practices and spoken to many participants in the market who have been willing to provide us with their insights into the operation of the market, we have not set out to carry out a comprehensive study of the leasehold market.

## Leasehold market

### *Size of the leasehold market*

20. The size of the residential leasehold market, in terms of the total stock of leasehold houses and flats in England and Wales, is difficult to establish. Some estimates[6] suggest that there are between four and seven million properties in the leasehold market.[7] Of this market, it is believed that two-thirds are flats and one-third houses.

21. Datasets compiled by the Office of National Statistics (ONS) for England and Wales track the flow (number of completed transactions) of properties (both new-build and existing properties) from 1995 onwards.[8, 9] For consistency with our own evidence gathering, we present the data for the period from 2000 onwards.

22. Leasehold is the norm for flats. From 2000 – 2018, almost all new-build residential flat transactions (671k) were leasehold. New build residential flats account for 86% of total new-build leasehold residential property sales, with the residual quantity (107k) relating to new-build residential leasehold houses.[10] This is shown in Table 2 below. Table 1 shows total transactions comprising existing stock and newbuilds:

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[6] See Select Committee report (2019) and Leasehold Knowledge Partnership oral evidence(2018)
[7] The Select Committee report (2019) references an estimate of 4.3 million leasehold properties by the Ministry of Housing, Communities & Local Government (2018). Referred to in the covering report as 'experimental official statistics', this figure is prepared based on a survey methodology which uses English housing surveys, land registry and council tax data to estimate the proportion of leasehold properties in stock, total dwellings and therefore the total number of leasehold properties. In response to this figure, the Leasehold Knowledge Partnership acknowledge in oral evidence (2018) that this figure may be understated due to the exclusion of Welsh properties and social housing.
[8] The most recent data set provided by the ONS considers the period 1 January 1995 – 31 December 2018. This period will be used for the following analysis.
[9] See Section 5 of the publication here for a summary of the main differences in methodology required to determine the size of the stock of leasehold houses and flats versus the number of transactions in a given period.
[10] Source: ONS data and CMA analysis, 2019.

**Table 1: Breakdown of residential property transactions (existing stock and new-builds) per tenure: 2000 – 2018**

| *Property type* | ***Total transactions*** | ***% of total transactions*** |
|---|---|---|
| Leasehold Flats | 3,391,727 | 19% |
| Freehold Houses | 13,867,025 | 75% |
| Leasehold Houses | 1,063,510 | 6% |
| **Total** | **18,322,262** | **100%** |

Source: ONS data and CMA analysis, 2019.

**Table 2: Breakdown of new-build residential property transactions per tenure: 2000 – 2018**

| *Property type* | ***Total transactions*** | ***% of total transactions*** |
|---|---|---|
| Leasehold Flats | 671,266 | 36% |
| Freehold Houses | 1,090,103 | 58% |
| Leasehold Houses | 107,026 | 6% |
| **Total** | **1,868,395** | **100%** |

Source: ONS data and CMA analysis, 2019.

23. Leasehold residential properties account for 42% of total sales of new-builds, the majority of which are flats (36%) as opposed to houses (6%). The remaining residential property transactions during the period relate to the sale of freehold houses (c. 1.1m, or 58%).[11]

### *Trends in new-build leasehold development*

24. Sales of new build leasehold houses were largely stable between 1995 and 2009 at approximately 5% of new-build property transactions (around 5k per annum) most of which were in the North West. This proportion began increasing in 2009, rising to 10% in 2015 – 2017, after which time coverage of leasehold houses and the adverse consequences arising from this form of tenure entered mainstream media. Subsequently, several developers ceased the development and sale of leasehold houses, leading to a sharp drop in sales in 2018. Total new-build property transactions did not fall in 2018 however; the drop in leasehold houses was offset predominantly by increasing transactions in freehold houses (see Figure 1 below).

[11] Relatively few freehold flats (c.8k) have been sold over the last 20 years and have thus been excluded from the analysis.

25. Our analysis has focussed on leasehold properties in England and Wales as there is a different legal system in Scotland and ground rents in Northern Ireland appear to be largely peppercorn.

**Figure 1 – Number of residential new-build property transactions by type per year: 1995 -2018**[12]

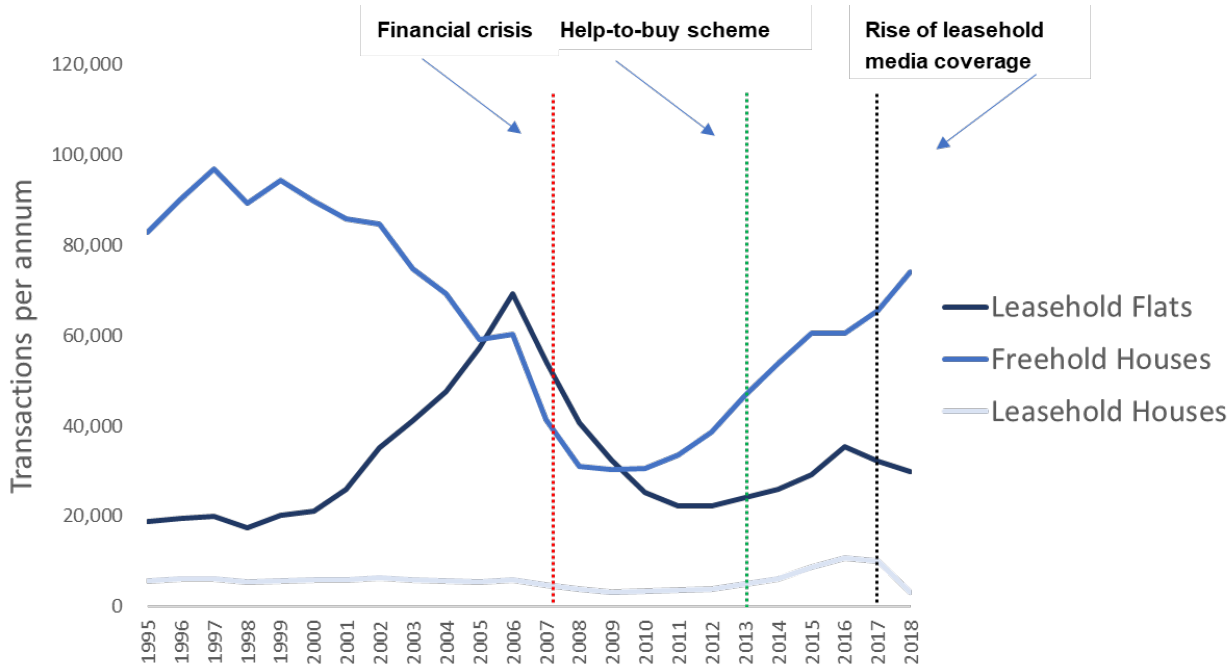


Figure 1 shows the number of residential new-build property transactions per year between 1995 and 2018 and the impact of key events on those transactions. Before the financial crisis, sales of leasehold flats were increasing, sales of freehold houses were decreasing and sales of leasehold houses were steady. Around the time of the financial crisis, sales of all three property types declined. Around the time of the introduction of the help-to-buy scheme, sales of all three property types increased. Around the time of the rise in media coverage, sales of freehold houses increased whilst sales of leasehold houses and sales of leasehold flats both declined.

### *Regional breakdown*

26. Of the total new-build leasehold house transactions during 2000 – 2018, 76% of sales have been in either the North West (61%), North East (8%) or Yorkshire and the Humber (7%).

27. It was noted by several developers that the leasehold model for houses is more pervasive in the North West and North East of the country. Developers said that this was ‘a matter of general custom’ and ‘common industry practice’. One developer noted that its experience ‘use is more typically expected by landowners’, while another suggested that the sale

[12] Source: ONS data and CMA analysis, 2019.

of leasehold houses in the North West and North East may relate to the inability to acquire freeholds there.

28. As the following graph shows, throughout the last 25 years there have always been more residential leasehold houses built in the North West than in the entire rest of England and Wales combined. The number of new build leasehold house transactions reached a peak in 2016 and dropped off sharply from 2017.

**Figure 2 – Residential new-build leasehold house transactions: 1995 – 2018**[13]

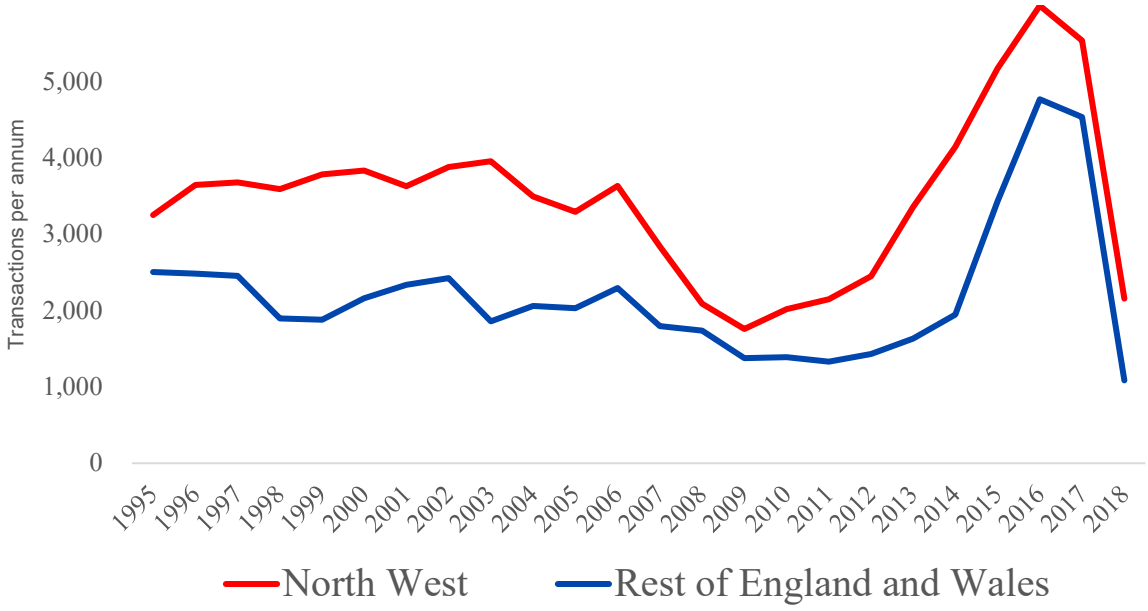


Figure 2 shows the number of residential new-build leasehold house transactions per year between 1995 and 2018. The graph illustrates how the number of transactions compare between two different geographical groups: the North West of England and the Rest of England and Wales. Overall, it shows that sales of new-build leasehold houses have been consistently higher in the North West than in the Rest of England and Wales combined. In both regions transactions began a rising trend in around 2009, peaking in 2016 before dropping off significantly in 2018.

### *Supply and demand side factors*

29. The share of new-build leasehold flats spiked between 2006 - 2008, having risen from approximately 17% of total new-build property transactions in 2000 to 54% in 2007 and 2008. The increase in the share of new-build leasehold flats (and associated fall in the share of freehold houses) coincided with changes in planning rules[14] which prioritised

[13] Source: ONS data and CMA analysis, 2019.
[14] See Planning Practice Guidance 3 for further details.

greater housing density and restricted the availability of land, promoting an increasing number of flats. The fall in the number of new-build property transactions between 2006 and 2009 is likely to have been exacerbated by the sub-prime mortgage and financial crises at the time.

30. The Help-to-Buy equity loan scheme was launched in England in April 2013. The scheme allows first time buyers to purchase a home with only a 5% deposit and has supported consumer demand. 81% of help-to-buy purchasers are first-time buyers, who may have only limited knowledge of property ownership.[15]

31. Between its start in 2013 and March 2019, 221,000 properties have been purchased under the scheme, rising from approximately 20,000 per year in 2014 to just over 50,000 per year in 2019.[16] The scheme has recently been extended until March 2023 and, alongside other government initiatives such as Stamp Duty Land Tax relief for first-time buyers and a positive planning environment, is expected to continue supporting property purchases across the country.

32. Overall, the total number of new-build residential long leasehold homes sold between 2000 and 2018 is c.778,000.

## The consumer journey

### *The significance of house purchases for consumers*

33. For most consumers, buying a house or flat will be their largest purchase and investment. Because it is a relatively infrequent purchase consumers are unlikely to accumulate significant knowledge of the process or of the salient characteristics of different forms of property ownership. Further, while the value of the purchase may make the consumer cautious, the sheer magnitude of the purchase price will typically make other amounts of money involved seem insignificant by comparison.

### *Mis-selling and 'onerousness'*

34. Because of the size of the investment, and because purchasers are capable of being blinded by the sums involved, it is extremely important

[15] See Ministry of Housing, Communities and Local Government (2019)
[16] See Ministry of Housing, Communities and Local Government (2019) for more details on the specifics of the help-to-buy equity loan and associated statistics.

that house sales are free from mis-selling, and that leases are free of clauses that are legally unfair.

35. By mis-selling we mean that the seller has made to a purchaser statements that are misleading or has omitted to provide a purchaser with information so that the purchaser is misled, that induce in whole or part the purchaser to take a decision or decisions in relation to a purchase. The statements in question will normally be about the nature, risks or benefits of the purchase. Alternatively, that the purchaser has been sold a product that is manifestly inappropriate for them or the seller has used unfair techniques to pressure the consumer.

36. The Consumer Protection from Unfair Trading Regulations 2008 (CPRs) provide consumers with protections against a range of unfair commercial practices which distort their decision making. In particular they prohibit commercial practices that are misleading (whether by action or omission) or aggressive, and that cause or are likely to cause the average consumer to take a transactional decision they would not otherwise have taken. They also prohibit generally unfair practices, which fall below acceptable standards and distort consumer's economic behaviour. Our investigation is therefore focussed on allegations of mis-selling which we think constitute breaches of the CPRs.

37. HCLGC's report raises concerns about terms in leases which are detrimental for leaseholders. These terms are referred to by HCLGC as 'onerous' and the report raises the question whether onerous terms are legally unfair. Consequently we have sought to establish whether onerousness is a concept that is capable of shedding light on the questions that have to be addressed from the perspective of consumer protection law. Our discussions with stakeholders have suggested two ways to think about onerousness. First, whether under the lease clause in question the cost to the homeowner exceeds the benefit received by the homeowner. Secondly, whether the clause affects the marketability or saleability of property. Lenders and developers tended to see what is onerous as that which affects marketability or saleability.

38. The second approach is often articulated by reference to lenders' mortgage lending policies: a lease term is onerous if it materially affects a person's ability to get a mortgage. Lenders' policies vary. Several lenders have changed their policies since the emergence of problems in leasehold and now have strict criteria against lending where a lease contains particular ground rent escalators, leading to problems for homeowners seeking to sell or mortgage their property. Other lenders operate on a

more discretionary basis, tending to focus on what will affect marketability or saleability as the basis of their policy.

39. We think that a clause in a lease may be onerous in different ways and there is little value in attempting a single definition or approach.

*(a)* For ground rent, because it is an annual charge arising out of the terms of the lease, a number of questions may arise – what does it pay for? Is there a fair exchange of value or legitimate cost recovery? What are the consequences of the obligation to pay? What are the consequences of non-payment?

*(b)* In relation to service charges and permission fees, items that are not annual charges on property but are instead either representative of maintenance or other costs incurred by the landlord it seems relevant to ask whether the charge that arises represents value for money – is a charge necessary and does it represent a fair exchange of value or cost recovery having regard to the matter that caused the cost to be incurred? To take this approach in relation to service charges and permission fees would in our view align with the legal tests for reasonableness.

40. However we should emphasise that consumer law[17] protects consumers against unfair contract terms and not against 'onerousness'. A term in a consumer contract is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer. Our investigation has therefore focussed on lease terms which we think are or may be unfair for the purposes of consumer protection law.

### *The sales process and allegations of mis-selling*

41. In the sale of new-build long-leasehold homes most sales take place after an initial sales process by the developer involving the developer's sales staff and the, at this stage still unrepresented, purchaser. This process has been the subject of much criticism from purchasers and has generated many allegations of mis-selling.

42. An important part of the sales processes we have seen is the 'reservation agreement' under which, in return for a payment that may be as much as

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[17] In particular the Unfair Terms in Consumer Contracts Regulations 1999 and Part 2 of the Consumer Rights Act 2015.

£500 to £1,000 the prospective home-buyer is given the exclusive right to acquire a property, which may not yet have been built, provided that exchange of contracts is reached within a fixed period. That period is frequently 28 days. The sanctions for prospective purchasers who do not exchange within that period are frequently waived. Nonetheless this early interaction between developer and purchaser is an important aspect of the sales process.

43. It is of concern that for many consumers the journey to owning a new build home may have started with scarcity messaging, incomplete statements about the form of tenure and with drip pricing (in the sense that brochures we have seen sometimes contain very little information about the price of property and even less on the level of ground rent or any escalation of ground rent or other fees and charges).

44. Several very serious allegations of mis-selling have repeatedly been made by homeowners about the conduct of developers and their sales staff in the process leading to the reservation agreement. These allegations tend to be variants of:

*(a)* the purchaser wasn't told that a house was leasehold or that fact only emerged during the sales process;

*(b)* no explanation was given to the purchaser of the differences between leasehold and freehold and/or the purchaser was told that a house was a 'virtual freehold';

*(c)* if the purchaser asked whether they could buy the freehold they might be told, correctly, that they could do so after two years but were given what would turn out to be an unrealistically low estimate of the freehold purchase price – often as low as £2000 in circumstances where the price would in due course be at least twice, and often several times higher;

*(d)* the purchaser was told the initial ground rent but not that it would increase;

*(e)* in more recent cases, purchasers were told that no houses would be sold freehold on an estate, only for houses to subsequently be sold freehold and sometimes for the same price as a leasehold; or

*(f)* again, in more recent cases, purchasers were given incorrect information about the developers' scheme of development.

45. It is not of course the case that all purchasers had such experiences but we have received numerous allegations and many purchasers have told us that, but for the alleged omission or mis-statement, they would not have purchased their house.

46. In addition to the alleged misrepresentations above some homeowners have told us that the interaction of ground rent with the assured tenancy regime under the Housing Act 1988 was not explained to them in the sales process.

47. Where a purchaser has 'reserved' a property, the potential for loss aversion borne of a natural tendency to feel a sense of ownership towards the property kicks in. This is often before key lease terms and their implications have been explained let alone fully understood by the prospective purchaser.

***The differences between leasehold and freehold property***

48. One point made repeatedly and forcefully by homeowners when we visited Maria Eagle MP's constituents is that when consumers talk to a developer about buying a house, or when they enter into a reservation agreement, many will simply think they are buying a house and will know nothing of the difference between leasehold and freehold property. As noted above, we have received many complaints that the difference between freehold and leasehold property was not explained during the sales process, or that leasehold properties were described as equivalent to freehold.

49. However there are important differences between leasehold and freehold tenure including that:

    *(a)* a leasehold property is held for a limited period of time whereas a freehold property is held indefinitely. A lease is thus a diminishing asset, becomes less valuable as time passes and at the end of a lease the property reverts to the freeholder (though the lease can be extended for the payment of a further sum);

    *(b)* a leasehold is held under the terms of a lease which will include positive and negative covenants (i.e. obligations) on the leaseholder and freeholder. In some instances a third party, such as a managing agent, will also be a party to the lease agreement and the leaseholder may have obligations to this third party and vice versa. A freehold property can be sold subject to negative covenants controlling its use but not subject to positive covenants;

*(c)* a leasehold can be terminated early for breach of covenant if there is a forfeiture provision in the lease. In practice, in the leases we are looking at, there is. However, the right to forfeit is subject to judicial control;

*(d)* a leaseholder can be required by the freeholder to perform work on the property;

*(e)* a leaseholder nearly always pays rent including ground rent;

*(f)* leasehold property is less likely to be acceptable security for a mortgage than freehold property, or can be more difficult to mortgage, depending on the length of the lease and the level of rent.

***The role of solicitors***

50. Following the reservation agreement, the next step in the consumer's journey is the conveyancing process. This is conducted between the developer and purchaser and their respective solicitors (or conveyancers). Developers often recommend solicitors – termed panel solicitors – to purchasers on the basis of the panellist's familiarity with the developer's sales processes and the legal aspects of the development in question. This practice has been the subject of criticism. It is permitted under professional conduct rules and there are obvious advantages in principle. However, the solicitor's duty is to act in the best interests of their client, with independence, honesty and integrity. There is a risk that this may be compromised if solicitors are concerned to avoid losing the recommendation that comes from the developer. This is a matter of concern and goes together with concerns about the effect of some inducements offered to purchasers to move to speedy exchange of contracts.

***Lenders***

51. Purchasers who need a loan to buy property will usually do so by taking out a mortgage with a bank or building society. The lender will wish to be confident that their borrower can afford to make the payments due under the mortgage and this assessment will take account of the wider costs of home ownership as well as the borrower's financial commitments and the current costs of owning the property such as council tax and utility bills. In leasehold property current costs will also include ground rent and service charges. The lender will also wish to be confident of the value of the property as security for the loan. While practice varies, the lender's concern may primarily be to ensure that the value of the property is

sufficient to act as security for the loan and the affordability of the loan for the purchaser, and not whether the purchaser is getting value for money. The lender's valuation is likely to be addressed to whether the property is good security for the loan. Purchasers may also ask a surveyor to survey the property but this is often a structural survey with the surveyor not being asked to express a view on the value of the property.

52. With respect to specific sections of the lease which require further examination, lenders are typically concerned about:

*(a)* length of unexpired lease at the point of purchase – evidence from our sample of lenders suggests that their requirement for the residual term of a lease at the time of purchase is 70 – 85 years, although this may depend on location and other circumstances affecting the value of the property;

*(b)* ground rents and service charges – as noted above, these are now often considered as part of the affordability assessment and taken into account in property valuation (though they may not have been in the past). Most lenders suggested that ground rents and service charges were acceptable if reasonable and not 'onerous'. By 'onerous' lenders noted some or all of the following considerations: whether the fees and charges will affect the borrower's ability to pay the mortgage; whether they will affect their ability as lender to realise the security of the property on sale; whether they represent an unfair or excessive burden (perhaps because of the size of increases in fees or charges); whether they will impair the ability of the homeowner to remortgage their property; whether they may cause the homeowner financial distress.

## Ground Rent

53. Where a property is sold on long leasehold, there is almost invariably an obligation to pay an annual charge – the ground rent – to the freeholder as a term of the lease. Around or shortly after the turn of the millennium, annual ground rent levels in the leases of new-build properties started to increase. While increasing ground rents, including those that double periodically, were not unknown before 2000 the term 'modern long lease' or 'modern leasehold' has been used to describe to us the long leases subject to substantial and increasing ground rents that emerged after 2000. A frequent explanation for the emergence of the modern leasehold is a combination of cash shortages in the building industry coupled with low interest rates leading to investors looking for different sources of safe

investments yielding low returns. However the emergence of the modern leasehold seems to pre-date, at least in part, the financial crisis of 2008.

54. The initial level of the ground rent, as well as any escalation clause is generally set by developers when the decision to commence work on a development is taken. Usually the ground rents on a development vary somewhat between properties according to their size (e.g. number of bedrooms, or square feet).

55. In most cases that we have seen, a modern leasehold was sold on a lease of at least 99 years. The majority of leases are for 125 or 999 years. Practice has varied between developers and developers may not always take a consistent approach where they have regional businesses with a degree of autonomy. Wherever there is a lease there is also a freehold interest, known as the freehold 'reversion', which exists at the same time and in the same property as the leasehold interest and will continue beyond the leasehold interest.

***Developers and investors***

56. The purchaser will enter into a lease with the developer but the developer may not maintain a relationship of landlord and tenant with the lessee. Whether the developer does or not will depend on whether the freehold is sold to a third party. If it is sold that third party will become the leaseholder's landlord.

57. This is because the role of housing developers is principally to procure land for housebuilding, regeneration or construction projects, to build and then sell properties. Developers may have different emphases in terms of the type of properties they construct, for example some specialise in the retirement sector, others specialise in different geographical locations.

58. But for many – though not all – developers it is not in their business model to retain freehold interests in the land upon which they have developed property and they do not therefore have the capability for the long-term management of housing. Freehold interests are or have in the past often been sold annually through legal entities created for the purpose.

59. In many cases therefore the developer will quickly drop out of the picture by selling the freehold. The value of the freehold lies mainly in the income receivable under it. This is chiefly ground rent but may also include direct or indirect gains from other charges (albeit that these other charges ought primarily to be compensatory rather than profit making). Because the freeholder has obligations under the lease it will, particularly if it owns

several properties or more, frequently appoint a managing agent to manage the property and to collect service charges to pay for those obligations, as well as to collect ground rent.

60. There are different ways in which developers may effectively pass the financial benefit of a freehold to an investor. At one end of the spectrum a developer may retain the freehold, sometimes establishing its own management company, because it considers that it has goodwill at stake in the continuing condition of the property but paying away ground rent to an investor. At the other end of the spectrum we have been told that developers sometimes dispose of freeholds before building has even begun. Subsequent owners of the freehold may set up (or contract out to) a ground rent management company and a building insurance broker as well as a management company, each of which will have separate dealings with the leaseholders. Freeholds may then be sold on to other investors with consequential changes to permission and service charges.

61. Despite legal protections[18] this 'pass the parcel' approach means that consumers often have an inadequate understanding of who owns their freehold, who manages it, and when it has been sold on.

### *The interest of investors in leasehold property*

62. The purchasers of freehold reversions are often institutional investors and/or pension funds. We understand that they are interested in the income arising from homeowners' obligation to pay ground rent because its characteristics match their long-term liabilities and provide a steady stream of income which helps to safeguard funds' long-term obligations.

63. The CMA thinks that the total value of the ground rent market – assessed as the value of the freeholds – is in the region of £10bn though some estimates put it much higher.

64. The interest of the investors may be held in one of a number of ways. The investor may acquire the freehold of a housing development giving it the right as landlord to receive ground rents payable. Alternatively it may lend to a third party who will acquire the freehold, with the terms of repayment

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[18] Under Part 1 of the Landlord and Tenant Act 1987 an owner of a flat has the right of first refusal which prohibits the freeholder from selling the freeholder's interest without first notifying tenants who may nominate an alternative entity to purchase the freehold of the flat. This requirement is subject to the caveats set out in Part 1 of the Landlord & Tenant Act 1987. Where the freehold of a house is sold the leaseholder does not have a right of first refusal but there is a duty on the new freeholder to inform the leaseholder that they have purchased the freehold (s.3 Landlord and Tenant Act 1985)

of the loan closely matched to the ground rents receivable. A third approach is to interpose a company between the landlord and tenant through which ground rent may be diverted away from the landlord and to the fund.

65. A number of reasons have been given to us to explain the interest of investors in ground rent. These include that ground rents:

*(a)* represent a long term – typically in excess of 75 years – and predictable income stream;

*(b)* are a secure income stream with a yield that exceeds gilts;

*(c)* escalate, often by RPI, which matches the liabilities of pension funds;

*(d)* have a strong underlying asset value;

*(e)* allow high asset diversification;

*(f)* release capital that might otherwise be withheld from investment under EU solvency requirements.

***Levels of ground rent***

66. Historically ground rent was viewed as payment for a lease of land in distinction to the further payment for the right to use the buildings on that land. It is impossible to generalise but there is a widely held view, though one with which some developers disagree, that until the early 2000s ground rents were most frequently set at peppercorn levels, or nominal sums, as some rent was thought necessary for a valid lease. In the modern property law of England and Wales, however, ground rent is not legally necessary where there is an initial premium nor have we seen persuasive evidence that it is commercially necessary to make the transaction between the vendor and purchaser of a lease effective (nor to promote a well-functioning property market).

67. The increase in the initial level of the ground rent, the use of escalation clauses, and the number of leasehold properties paying higher ground rents over the last 20 years has created two categories of leasehold properties.

68. First there are a large number of historic-stock leasehold properties with annual ground rents at low or nominal levels (typically £50 or less). It is

difficult to find reliable figures for the number of historic-stock leasehold properties, though we estimate these to be around 3.5 million.[19]

69. Secondly, there are modern long lease properties with annual ground rents typically at several hundred pounds and usually increasing over the term of the lease. These are a mix of flats and houses across England and Wales. There were 671k new-build leasehold flats and 107k new-build leasehold houses sold since 2000. While not all of these will be modern leaseholds, in meetings with developers and investors we have been told that the vast majority of these are modern leaseholds.

70. We have asked developers and investors about the levels of ground rent for those properties where the ground rent is not a peppercorn. We have also asked investors how many properties they own that have a ground rent above the thresholds for an assured tenancy set by the Housing Act 1988: £1,000 per year in Greater London, and £250 per year elsewhere in England and Wales. Our conclusion is that, across the country, non-peppercorn ground rents are typically set at an initial rate of £100 to £250. As a result, ground rents above £1,000 in London are quite rare, but ground rents above £250 outside London are more common.

71. This means that the risk that homeowners are likely to fall or to have fallen into the assured tenancy trap is greater outside London.

### *Types of escalation of ground rent*

72. There is no standard approach to ground rent in modern leaseholds and different homeowners are subject to different obligations. Ground rents can be fixed or they can be subject to a formulaic increase (often termed an 'escalator'). Escalators generally fall into the following categories:

*(a)* fixed multiple – these are usually doubling clauses, with ground rent doubling at specified review periods. Where leases contain a doubling clause the ground rent often stops doubling after a number of years (the most common case being after 50 years) or after a specified number of increases, for example five. It is more common for such clauses to specify doubling until an anniversary review date rather than the number of incidences of doubling;

*(b)* stepped increase – some leases specify stepped increases. This can be a fixed increment, such as a £100 increase at every review period,

[19] This is estimated to be split 63% flats (2.2m) and 37% houses (1.3m) – CMA analysis, 2019.

or it could increase by the original ground rent amount at each review period. Alternatively, some leases specify increasing increments, such as £75 per year for the first 25 years, £150 per year for the following 25 years, £275 per year for the next 25 years and £425 per year for the remaining 23 years;

*(c)* indexed – ground rent escalation clauses can be linked to a published index, most commonly the RPI, though some ground rents are linked to an Average Earnings Index, or the House Price Index (HPI). An escalation clause can also be linked to more than one index, specifying for example that ground rent will increase by the higher of either RPI or HPI;

*(d)* market value – some ground rent increases are linked to the market value of the property, while others are linked to the market value of a block of flats.

73. Data from developers indicates that the most prevalent form of increase in ground rent is by RPI.

74. The ground rent review period can vary between 1 and 99 years. Of the new-build residential properties sold during 2000-2018 (c.1.9m), we have identified around 21,000 which were sold with a doubling escalation, of which, 13,000 had review periods of 10 or 15 years. Based on this information, we estimate that the total number of properties with 10-year or 15-year doubling clauses is about 18,000.

***Consumer protection issues in ground rent***

75. We think there are at least four main issues to consider when considering ground rent and ground rent increases from the perspective of consumer protection. Others may emerge during our further investigation.

76. Firstly, in assessing the fairness of ground rent we have to ask the underlying question of what ground rent is for. The homeowner's obligation to pay ground rent may be part of the consideration given for the lease. However a number of people involved in the market, when asked the question what homeowners receive in return for ground rent, are prepared to say quite candidly that homeowners receive nothing in return and that ground rent is simply an income stream (though we were also told that this income may provide an incentive for long term property management). Others give examples of what it pays for but very often these seem to be items that ought to fall within a service charge or,

alternatively, are examples of the use of ground rent to meet costs that prove little more than that ground rent is a source of cash.

77. The CMA is concerned that ground rent has little justification. Justifications for ground rent we have heard include that:

*(a)* ground rent is an ongoing payment for the continuing right to use the land. In this analysis there is nothing transferred to the leaseholder in return for the payment, or the increased payment over time, it is simply rent. However a purchaser may pay a substantial initial purchase price for a long leasehold, for example £400,000 for a house on an estate in Lancashire. It is not clear why they should pay an additional annual sum, that could be as much £300 p.a. and that may double every 10 years, to enable them to occupy their home;

*(b)* to fund purchases and development of land by developers that would otherwise not be commercially viable. It has been put to us, though somewhat hypothetically – we have been given no very persuasive example – that ground rent (and the sale of the right to receive ground rent) may have increased the spending power of developers and that this may have brought land into the market for development that would not otherwise have been available. We are sceptical that this effect is much, if at all, more than a hypothesis. If ground rent is not available to enable developers to source property from landowners, the market is likely to adjust with sellers unable to demand higher prices and all developers' offers being on a level playing field with reduced profits for landowners;

*(c)* making homes more affordable – through a reduction in upfront premium, balanced by deferred ground rent payments, akin to taking out a loan. However, we have found no persuasive evidence that home prices have been significantly reduced when compared with equivalents with peppercorn ground rents.[20] Moreover on a number of estates we have seen evidence of houses that are essentially the same being sold for the same price whether leasehold or freehold. Finally, it is unclear how deferring some of the consideration would make the property more affordable, since the homeowner should end up with essentially the same total annual expenditure on mortgage interest and ground rent regardless.

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[20] We know that leasehold properties sell for less than freehold properties, and there is a body of academic research that supports this proposition. It is difficult to distinguish from this any further discount on leasehold property arising from the ground rent to be paid over time.

78. Secondly, there are the most controversial escalators: the clauses that double more frequently than every 20 years. Not only do these convert annual payments into large sums quite quickly – and significantly above current rates of inflation – they may well create problems in selling or mortgaging a property because lenders either have policies that prevent lending against such properties or, in the absence of a policy, are likely to exercise a discretion that may lead them not to lend.

79. Thirdly, there is a problem where ground rents exceed £250 outside London and £1,000 in Greater London. Where they do, they convert the homeowner's tenancy into an assured tenancy under the Housing Act 1988.[21] This too can create a problem in obtaining a mortgage depending on the provider.

80. Fourthly, there are those ground rent obligations that increase with RPI.[22] In the very specific context of increases in ground rent there are four principal concerns about RPI:

*(a)* homeowners may well not understand how an RPI increase is calculated (and this problem may be compounded by the drafting of the lease clause);

*(b)* the quantum of an RPI based increase is uncertain;

*(c)* it is unclear why in principle RPI is a suitable index by which the lease value of property, if such it is, should increase;[23]

*(d)* at an RPI increase of 3.7% over 20 years an RPI escalating clause produces an increase equivalent to a 20-year doubling clause.

## Permission fees and service charges

81. As a homeowner, the purchaser of a long leasehold is not only liable to pay ground rent. Many homeowners also have a liability to pay permission fees and service charges. Our investigation has shone light on issues

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[21] An Assured Tenancy is defined at section 1, section 19A and Schedule 1 of the Housing Act 1988.
[22] Price index clauses are also assessable for fairness.
[23] RPI is based on a basket of over 190,000 prices and though there are some property related prices in the mix – council tax, mortgage payments and perhaps, with some circularity, ground rent increases – RPI is not obviously a reflection of changes in property value. Instead it tracks the purchasing power of pound sterling. Comparisons of RPI and increases in house prices show that RPI is not a reflection of the latter. To be clear, this is not to advocate that changes in house price or land be used as a basis for increases in ground rent. Changes in house prices are volatile and likely to exceed RPI. More importantly though we do not think that ground rents in modern leaseholds have much if anything to do with the value of property or land.

relating to such charges, some of which lack authority under the lease, or lack transparency, or are not cost-reflective. In some cases it is difficult to see that they are either justifiable or necessary.

82. Leases tend to set out the items recoverable by service charges but do not commonly specify a cost. Leases may say nothing about permission, specify a need to seek permission but not a charge, or specify a need to pay but do not identify for what and/or how much. This reflects the need to 'future-proof' for variation of costs over time, and instead the level of recoverable cost is often described as what is 'reasonable'.[24] Changes in freehold ownership can lead to changes in the charges reflecting the different approaches of different freeholders and their managing agents.

83. In law permission fees, other administration charges, and service charges are treated differently with different statutory protections for homeowners for each charge. We have received complaints that at least some landlords or their agents do not take these distinctions properly into account. There appears to be a further problem in that freeholders and their agents do not always tailor their communications and approach to match individual lease terms.

***Problems with permission fees and service charges***

84. We have received complaints that, in addition to the fees provided for in a lease, landlords or their managing agents routinely charge high amounts for any request made by a leaseholder, and that they may do this notwithstanding the absence of an express contractual basis to charge fees.

85. Even where permission fees are authorised by a lease we have received numerous complaints. These vary from homeowners complaining of having to pay landlords for their consent to install a boiler or to build a conservatory, (even, in the latter case, where the conservatory has been approved by or requires the approval of the local authority), to being charged for erecting a 'for sale' sign on a house on an unfinished housing development.

86. It is not only the occasions of charge that are complained about. The level of the charge can also be controversial. We have received complaints about very high hourly rates, high minimum charges and a proliferation of

[24] If the charge is variable in the lease, it is subject to a test of reasonableness - Commonhold and Leasehold Reform Act 2002, Section 158, Schedule 11, Paragraph 2.

items – including the fees of numerous advisors – being combined in a single permission fee without apparent justification.

***Service charges***

87. In most of the leases we are looking at there is in the lease a simple obligation to pay a service charge which cross-refers to a schedule of items to be paid for. The schedule may or may not include an explicit 'catch all' clause to cover variation. Typical items covered by the service charge include the maintenance of garden areas, service infrastructure, lighting, as well as sinking funds, insurance, taxes, and the payment of contractors' and management fees.

88. Complaints we have received include complaints about fees rapidly escalating beyond initial estimates, management fees in excess of the expected norm of 15% – in one case over 50% – of the total costs billed, of big sinking funds, high building insurance costs – in excess of quotes obtained independently[25] – and charges for work not done.

89. By section 19 of the Landlord and Tenant Act 1985 a service charge can only be recovered to the extent it is 'reasonable'. Reasonableness has three dimensions (1) reasonableness in the amount charged (2) that the charge was reasonably incurred and (3) that works were completed or services were provided to a reasonable standard. A service charge should be compensatory rather than a means of making a profit, although the terms of leases and the practice of landlords often appear to allow or enable a profit to be made through this mechanism. Major works by the freeholder are subject to a consultation regime where the leaseholder must be notified and consulted in advance about costs for major works before any works are carried out.

90. The Secretary of State has approved a code of practice in relation to the management of residential property and service charges.[26] The most recent approved code is the RICS Service Charge Residential Management Code, 3rd Edition[27] ('the Green Book') which was approved

[25] The broker may have been established by the freeholder – in such cases there is an incentive to spend due to the management fee % applied to the total.
[26] Section 87 Leasehold Reform, Housing and Urban Development Act 1993.
[27] https://www.rics.org/uk/upholding-professional-standards/sector-standards/real-estate/service-charge-residential-management-code/.

in 2016.[28] Whilst a freeholder is not liable for breaching the rules of the Green Book, as an approved code it is admissible as evidence in court proceedings and can be used by the Court to determine a question arising in proceedings.[29]

91. As lease terms usually state that charges must be reasonable, disputes focus on the fairness of cost margins. It is hard to form a judgement without a better understanding of the underlying true costs in each case.[30] Such complaints about price levels are not well suited to our consumer enforcement powers except in the case of mis-selling where consumers are quoted figures on their reservation forms which turn out to be significant under-estimates.

92. Consumers are, however, able to challenge high fees and charges provided they have a redress mechanism that does not disincentivise them either through its cost, its complexity or its accessibility. For this reason we believe that consideration should be given to whether access to redress can be made easier for homeowners.

## Next steps

93. As we note above, the CMA's investigation into consumer protection law issues in the leasehold housing market is still ongoing. This update therefore does not set out the CMA's final position on these issues. However, the CMA has already identified a number of serious concerns and proposes to take the following immediate next steps.

### *Enforcement action in relation to ground rent and mis-selling*

94. The CMA is preparing to take enforcement action in relation to two key issues. First, to tackle certain instances of mis-selling of leasehold property. Second, to address the problems faced by homeowners from high and increasing ground rents. The CMA enforces consumer protection law through the courts, using powers set out in the Enterprise Act 2002, such that the final decision about whether the law has been broken is taken by a judge. The CMA is, however, able to accept formal

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[28] Approval of Code of Management Practice (Residential Management) (Service Charges) (England) Order 2016/518

[29] Section 87(7) Leasehold Reform, Housing and Urban Development Act 1993

[30] E.g. the 'simple cost of changing a light bulb' could potentially include use of a contractor with out-of-normal hours payment, subsistence, petrol costs, and purchase of a specialist ultra-long life bulb.

undertakings from traders in lieu of court action where they agree to address the CMA's consumer protection concerns.

95. We will publish further information in the coming months in relation to our enforcement action in line with our published guidance on transparency and disclosure.[31] We also intend to support homeowners by preparing and publishing information to assist them in understanding their rights.

### *Working with government*

96. We will also continue our engagement with MHCLG and other stakeholders to identify and promote solutions to some of the underlying problems in the sale of leasehold property.

97. As we note above at paragraph 7, action by the CMA alone can only partially address the concerns we have identified. The government is taking forward a number of policy and legislative initiatives that aim to improve outcomes for leaseholders. This includes legislation that will effectively abolish ground rents in future long leases.

98. We strongly support these measures, and will work closely with MHCLG and others to inform new legislation and other solutions that will shield homeowners from harmful practices. This includes a number of the recommendations that we have set out above in relation to assured tenancies, systems of redress for leaseholders, and improving the quality of information provided to consumers early on in the buying process.

99. We also intend to work with government and other key stakeholders to inform and develop policy and legislation to address the failure of some of the existing checks and balances within the leasehold housing market.

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[31] *Transparency and disclosure: the CMA's approach* (CMA6).