New build leasehold properties

cml
Council of Mortgage Lenders

Background

This document provides information on the issues relevant for lenders and their advisers concerning lease terms for **new build leasehold properties** in England and Wales**,** which may have a particular implication for the value of the property and for affordability of the mortgage loan.

This document is for information only. It does not form part of, or override any CML member's lending policies or guidance to their professional advisers such as valuers or conveyancers. Nor does it take precedence over relevant clauses of the CML Lenders' Handbook, such as s 5.14.1 and 5.14.9.

The document does not address all lease terms. It is the responsibility of the legal adviser to advise the lender client on the lease, in accordance with the CML Lenders' Handbook, and any special instructions. **It remains the responsibility of the prospective purchaser to undertake their own investigations into the property they wish to purchase.**

*NB: It is important to note that the considerations and policies of individual lenders for lending on **existing leasehold property** and **shared ownership property** may differ, particularly around acceptable lease length, although the overarching considerations will be the same.*

Overarching considerations for lenders

Affordability

Lenders need to establish if the lease will have any impact on the borrower's affordability. It is a regulatory requirement for lenders to take account of all known future changes to a borrower's income and expenditure that could affect the affordability of their mortgage. As such, understanding the level of ground rents, how they increase over the mortgage term and other known charges due under a leasehold agreement, are relevant to lenders' assessments of affordability.

A lender's risk might also be increased if ground rent, or other charges are disputed by the leaseholder borrower in the future and the borrower does not pay while in dispute, as in such situations the lease could potentially be forfeited and the lender's security put at risk.

Property value and saleability

If ground rents and other charges appear to have an impact on the value and saleability of the property, lenders may, together with other matters, take this into consideration in deciding whether, and how much, to lend. **Lenders will rely on the advice of professional advisers, particularly the mortgage valuer, here.**

The length of the lease term also has relevance to the value of the property, as at a certain point, it may be necessary to negotiate and pay for an extension of the lease to preserve the property's value for the future.

General points

- Given that lenders must consider both affordability of the borrower, and the sustainability of the value of the property, lease terms which involve obligations for future payment, such as ground rents, are more likely to be considered acceptable for lending purposes if they are set at levels that will not materially change mortgage affordability in the future, or impact on the value of the property; and that the lease length is suitably long (i.e. is granted for hundreds, rather than tens of years).

- Lenders may query why a property is offered as leasehold. This is particularly so for leasehold houses.

- It is important that lease information for new homes is made available as early in the home buying process as possible, so that conveyancers and valuers can provide advice and lenders can make appropriate lending decisions.

- In relation to ground rents, lenders would expect to see nominal ground rents, reflecting the origins of the ground rent being 'peppercorn' in nature.

- Under current leasehold legislation, there are certain provisions which present a risk that the lease may be terminated or forfeited by the landlord (freeholder), leaving the property owner without a leasehold interest, and the lender mortgagee without a security. Therefore, lenders will expect that a conveyancer acting on their behalf advises on such risks and how they might be mitigated. An example is the relevant provisions of the Housing Act 1988 in relation to the creation of an Assured Tenancy where the ground rent exceeds £250 per annum or £1000 in Greater London.

Specific considerations

Lenders will expect professional advisers such as conveyancers and valuers to consider:

- The length of the initial lease term granted. As a general principle, longer lease terms will help sustain the property's value for longer, as there should not be a need to seek an extension of the lease in the medium term (i.e. over the term of the mortgage). Lenders using the CML Lenders' Handbook already stipulate a **minimum lease residue requirement** (see s 5.14.1 of the CML Lenders' Handbook).
    - Lenders recognise that there may be different lease lengths for houses and flats.

- The mortgage term in relation to the lease term, with particular regard to a likely review of the lease once 80 years or less are remaining.

- The initial annual ground rent figure. Professional advisers should take into consideration:
    - the level of the ground rent in relation to the property's market value,
    - the type of property (e.g. a flat or a house)
    - whether the ground rent is fixed or rises periodically,
    - If the ground rent does rise periodically, the formula by which it rises.
    - Where the property value is below £100,000, some lenders may wish to see a de minimis maximum initial ground rent figure (e.g. £100) is applied.
    - Whether the ground rent figure is at a level which triggers legislative provisions (such as under Part 1 of the Housing Act 1988), potentially creating a risk for the lender's security.

- The ground rent review formula (if not a fixed figure). Professional advisers should take into consideration:
    - The CML Lenders' Handbook at s 5.14.9, which provides that lenders will accept a periodic increase in ground rent, provided that the amount of the increased ground rent is fixed or can be readily established and is reasonable.
    - Where the formula is one which uses increases in line with an index, whether the index is a recognised UK index and is appropriate and/or acceptable to them. Some lenders may also expect a cap on the maximum ground rent amount, to guard against the ground rent reaching an unreasonably high sum, which could impact on the property's value, the continued affordability of the mortgage and the future saleability of the property.
    - Some lenders may be concerned to see the use of compounding formulas, or the use of minimum increases, in conjunction with an index-linked formula.
    - Where the formula does not link with a recognised index, and instead uses a multiplier (e.g. doubles) at set intervals, the frequency of the rent review intervals. There is no single industry view on a minimum acceptable frequency, as it may depend on other factors such as the initial amount of the ground rent, and whether there is a cap on the number of times the rent is reviewed.

- Other fees charged under the lease
    - Where other fees are charged under the lease (for example, on a transfer of equity) lenders will expect that these are set at reasonable levels. Where the fees follow the ground rent formula (for example, if they are set at 50% of the prevailing ground rent), lenders will have similar expectations as set out above for ground rent formulas.