To the House of Commons Public Bill Committee

Written evidence submission on the Leasehold and Freehold Reform Bill

From the CFO of Annington Property Limited

Executive Summary

1. For the reasons given below, I respectfully ask that:

- Schedule 7 is amended so that it only applies to ground rents.

- Provision is made that the standard valuation method is not compulsory if the tenant is a Government department.

Brief introduction to Annington Property Limited and why I am making this submission

2. I am the Chief Financial Officer at Annington Property Limited ("APL").

3. In 1995 the Ministry of Defence ("the MOD") decided to offer to the private sector a sale and leaseback of a substantial number of service family accommodation sites comprising many thousands of residential units – mostly houses but with some flats. The offer was that the MOD would sell the sites to an investor who would grant a long lease back to the MOD of each site at market rents determined by the MOD.

4. A report from the National Audit Office in August 1997[1] explained how the rents for each site were determined:

> "*2.7 The sale was on the basis that the Department would pay the new owners rent for those properties they lease back. The Department decided on quarterly rents, paid in advance, to reflect commercial practice, and their aim was that rents would reflect market rates. The initial rent was based on assessments by the Department's property advisers of Assured Shorthold Tenancy rents payable on similar properties, aggregated across the estate and then discounted by 58 per cent to reflect the bulk nature of the lettings and certain features of the Department's occupation*".

5. A tender exercise took place attracting 19 bidders. APL made the highest bid at £1.662 billion. Contracts between APL and the MOD for a sale and leaseback agreement were

[1] www.nao.org.uk/wp-content/uploads/2018/01/Ministry-of-Defence-The-Sale-of-the-Married-Quarters-Estate-August-1997.pdf

exchanged in September 1996 and completion took place in November 1996, with the underleases granted to the Secretary of State for Defence.

6. The transaction related to 765 sites on which there were 55,051 houses and flats. In the case of each site, the MOD granted a 999 year headlease and APL granted the MOD a 200 year underlease. Currently, therefore, each underlease has an unexpired term of 173 years.

7. The underleases gave the MOD the right to hand back units, which it has regularly exercised. As a result, currently there are around 37,000 dwellings on 494 sites held by the MOD under underleases from APL.

8. The underleases included provision for the periodic review of the rent payable by the MOD to APL, intended to produce a market rent for each site. After a lengthy arbitration process, the MOD and APL agreed the current rent.

9. In 1996, the Leasehold Reform Act 1967 only applied where the tenant occupied the house as their only or main residence for 3 years, and enfranchisement was, therefore, irrelevant at the time of the sale and leaseback given that the MOD itself would not reside in the dwellings that were let.

10. However, the Commonhold and Leasehold Reform Act 2002 abolished that residence requirement. The MOD claims that, as a result, it does have the right to enfranchise in respect of the houses held under the underleases under the Leasehold Reform Act 1967. That is disputed by APL and there is currently litigation between APL and the MOD to have that issue determined. In May 2023, the High Court determined that the MOD does have the right to enfranchise. APL is appealing that judgment and the appeal is fixed for hearing in July 2024. There is ongoing litigation before the Court of Appeal regarding whether the MOD (as it contends) has the right to enfranchise.

11. APL expects to succeed in that litigation and if it does, then the Bill will not affect it. However, if it loses, then the Bill may affect APL, hence this submission.

12. There are two aspects of the Bill that APL submits should be amended. I will address each in turn.

Schedule 7 should be amended so that it only applies to ground rents

13. Schedule 7 creates a right for a tenant of a house or flat held under a lease with 150+ years unexpired to have the lease varied so that the rent becomes a peppercorn rent.

The premium to be paid for this variation is determined using a capitalisation rate prescribed by the Secretary of State.

14. As drafted, this Schedule would apply to each house and flat held by the MOD under an underlease from APL, because each underlease has an unexpired term of more than 150 years.

15. However, this appears to be the result of a drafting error, and that the intention was that Schedule 7 would only apply to a ground rent, not to a market rent such as that payable by the MOD to APL.

16. In that regard, the Law Commission's final report, Law Com no.392, para 3.112, recommended:

> "*Leaseholders who have a lease with a very long remaining term (we suggest 250 years, but the threshold could be set lower if Government wished to do so) should be entitled to extinguish the* ***ground rent*** *payable under the lease (on payment of a premium) without extending the term of the lease*".

17. The explanatory notes published at the same time as the Bill made it clear that the intention of the Department was that the right conferred by Schedule 7 would only apply to a ground rent. It says at para 15:

> *"The Bill introduces a new right for leaseholders who already have very long leases (with over 150 years remaining) to buy out their* ***ground rent*** *without extending the term of their lease or buying the freehold."*

18. Para 111 of the explanatory notes says the same:

> *"Clause 21 brings Schedule 7 into effect. Schedule 7 make provision for a new enfranchisement right to buy out the* ***ground rent*** *under a very long residential lease."*

19. Para 406 of the explanatory notes says the same:

> *"Paragraph 1 explains the purpose of Schedule 7, which is to confer on a qualifying tenant the right to buy out their* ***ground rent*** *("the right to a peppercorn rent"). The exercise of the right involves a variation of the tenant's lease permanently to replace the (relevant part of the) rent with a peppercorn rent."*

20. The delegated powers memorandum also published at the same time as the Bill also says the same at para 97:

"*The Bill introduces a **ground rent** buy out right, under which tenants with more than 150 years remaining on the lease will be able to reduce their rent to peppercorn on payment of a premium. The ground rent buy out right is to enable a leaseholder with a long lease to buy out the **ground rent** without extending the lease, since by doing so they only pay the term value, and not the reversion value too – in other words, it's cheaper than paying for an extension, when an extension is probably not desired due to the long lease".*

21. However, Schedule 7 (as drafted) applies to any rent payable under a 150+ year lease of a house or flat, including one where a market rent is payable.

22. This mistake can be corrected simply by providing that Schedule 7 does not apply to a lease for which no premium was paid by the tenant. That is how, I understand, the Leasehold Reform (Ground Rent) Act 2022 ensures that only ground rents are caught by the Act. That approach would also be consistent with how "*Ground rent*" is defined in the Government's consultation to the Bill i.e. as "*a payment made by the leaseholder to the freeholder under the terms of a lease that was granted in return for a premium*."

Provision should be made that the standard valuation method is not compulsory if the tenant is a Government department

23. As drafted, the Bill requires the standard valuation method to be used even in the case of a rent payable under the lease for which no premium was paid by the tenant, unless the lease is a "market rack rent lease".

24. I was not involved in the sale and leaseback in 1996, but I understand that the original rents payable under the underleases were market rack rents or reasonably close to market rack rents, and that the parties entered into the underleases with the intention that the rents would be a market rack rent. Therefore it is very likely that the Bill as drafted will not require the standard valuation method to be used in our case if the MOD is entitled to enfranchise.

25. However, in order to avoid a potentially long, difficult and expensive dispute with the MOD on this point, involving an extensive enquiry into the events surrounding the sale and leaseback in 1995-6, for the reasons explained below APL considers it would be prudent for the Bill to be amended to provide that the standard valuation method is not compulsory if the tenant is a Government department. This will put the matter beyond doubt.

26. If the standard valuation method does apply to the underleases which the MOD holds from APL, it will mean that the Government, as tenant, can compulsorily purchase APL's

property at a price fixed by the Government itself. The Government would both be the buyer and the person determining what price was paid.

27. The unfairness of this is obvious. It would give rise to clear conflicts of interest and be contrary to the fundamental principle of natural justice that a person must not be judge in their own cause. It would be a departure from the established practice which has applied to all forms of compulsory purchase for over 200 years, which is that the price payable on compulsory purchase by a public authority is fixed by an independent body, not by the purchasing authority itself. This would be a breach of Article 6 and/or Article 1, Protocol 1 of the European Convention on Human Rights as given effect to by the Human Rights Act 1998. In my view, this would severely damage investor confidence in the UK as a safe place to invest money where the rule of law applies.

28. We suggest the following provision which would cure this problem

"*The standard valuation method is not compulsory if the tenant is a Government department, or is held on behalf of the Crown for the purposes of a Government department*".

Statement of truth

The facts stated in this submission are true to the best of my knowledge and belief

Signed: 

Dated: 22 December 2023