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Landlords leasing land to investors must address enfranchisement rights, say Simon Bagg and Philip Rainey QC

Social landlords are looking for ways to build homes without subsidy. Investors, such as pension funds, are looking to invest in the residential property market. To bring the two together, one option is for an investor to take a long lease of a plot of land from a social landlord for a premium.

The landlord uses the premium it gets to build homes. The investor grants a lease of the same plot back to the landlord, with the rent paid by the landlord producing an income for the investor. Each side achieves its goals, funding for development and an income stream, but what are the risks? One is enfranchisement rights.

Investors usually want social landlords to lease the plot from them for about 45 years. Under the Leasehold Reform, Housing and Urban Development Act 1993, if the social landlord has owned the lease for more than two years, and the original term of the lease is greater than 21 years, the social landlord (as the investor's tenant) may have the right to extend the lease for 90 years at a peppercorn ground rent.

The disadvantage for the investor is that they will lose their income stream, which was the initial reason for the investment. The investor will be compensated, but is it sufficient?

In the short term, the social landlord may not wish to extend its lease. But unless prohibited by the lease, the social landlord may sell its lease, and a new tenant may apply to extend the lease. One solution (if appropriate) is to grant a 20-year lease, with a further 20 years to commence immediately thereafter.

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