

Ground Rents

“The rent of a house may be distinguished into two parts, of which the one may very properly be called the Building-rent; the other is commonly called the Ground-rent.”

Adam Smith “An Inquiry into the Nature And Causes of the Wealth of Nations” 1776

Ground Rents are often complex and can be quite confusing to the layperson and landlords alike. This article by Jeremy Davies, an investor in Ground Rents through Elmdon Real Estate LLP, should clarify matters somewhat.

What is a Ground Rent?

A ground rent is created when a freehold property is sold on a long lease, either divided as flats or as a single house. In the past the creation of a ground rent on land provided an income to the landowner, while the builder would lease the land to build the house and then sell it on completion. Unfortunately inflation has eroded the value of most ground rents with long leases and non-rising incomes, so the value of landowner freehold interest's where there is no prospect of a reversion within 150 years is marginal.

Why do people create ground rents?

If you are converting a period house into flats and selling them individually, you will need to create a freehold/leasehold structure to handle property maintenance and collective block insurance. Some developers include a 'Share of the Freehold' in the purchase of a leasehold flat, often putting the ground rent at a nominal amount. Purchasers however, especially when they do not occupy it as their main residence, might prefer a third party to handle the management and administration of the block. This is also lucrative for the developer, as he can sell the 'freehold ground rents' for a high multiple of the passing income. Not for no reason is this often known as the 'builders pension fund'.

Why do people sell ground rents?

Economies of Scale in Administration

The administration of ground rent collection and block administration benefits from economies of scale. As such while it is a hassle to collect rent from a few converted houses by writing to them individually each year, a ground rent investment company will have an automated database which will greatly reduce the time expended per property in collecting the rent.

Difficult to Raise Finance Against

Most High Street Banks will not lend against ground rent portfolios if the income is less than £100,000 per annum. This is because of the small individual lot sizes, the difficulty in valuing individual ground rents and the legal work involved in registering charges against hundreds of titles.

Realise Capital Sum for Other Purposes

Individuals are often surprised that there is an active market for ground rent investment. Many have previously tried to sell them locally, and received either little interest or derisory prices. Common uses of capital include home improvements, tax efficient pension fund contributions or in the case of developers the purchase of further land/ sites.

Search for Liquidity

As the residential market turns at the time of writing (June 2008), individuals are keen to sell whatever part of their portfolio is the most 'liquid'. While one would struggle to sell a flat to another investor which requires a high LTV loan at the moment of writing, purchasers of Ground Rents are rarely reliant on bank borrowing and take a 'long term' view which places little emphasis on falling capital values. In addition because a large component of the value of a ground rent is the income not the capital value of the property, they have more of a correlation to changes in income capitalisation rates than changes in residential property valuation.

I am building a block of flats , and want to sell the ground rents profitably at the end of the development to an investor. How can I maximise the ground rent value while not detracting from the value of the long leasehold properties I intend to sell?

Good management is key. Reputable ground rent investment companies will insist on the separation of management and ownership, to avoid conflicts of interest in administering the block's maintenance. You could write a provision for this into the lease.

Rising ground rents with fixed or geared increases. The value of a ground rent has a strong correlation to the way in which the income grows in future years. At the time of writing RPI tracking at ten year intervals is our favourite.

Reasonable lease lengths are key. Initial leases in excess of 150 years are unattractive, because the resulting value of the reversion is minimal. A 125 year lease provides a nice compromise between the concerns of apartment purchasers and the desires of investors.

Sell prior to construction. Most ground rent investors are happy to purchase prior to construction starting and hand over a large deposit on exchange for the opportunity. Completion then occurs on the sale of the last flat. This also avoids the need for Section V notices to be served on lessees giving them the option of pre-emptive purchase, as long as the sale of the ground rents occurs prior to the sale of 50% of the flats.

I want to sell ground rents, who should I speak to?

The author of this article operates [Elmdon Real Estate LLP](#), a ground rent investment company, and the website www.groundrentswanted.com. He would be happy to give indicative prices on ground rent portfolios or single ground rents and is available on 0800 756 6412 or by email to info@elmdonrealestate.com.

See Also: <http://www.landlordzone.co.uk/dir/ground-rents.htm>