



# Valuation of residential leasehold properties for secured lending purposes

England and Wales

1st edition, May 2021

# VALUATION OF RESIDENTIAL LEASEHOLD PROPERTIES FOR SECURED LENDING PURPOSES

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# RICS professional standards and guidance

## RICS guidance notes

### Definition and scope

RICS guidance notes set out good practice for RICS members and for firms that are regulated by RICS. An RICS guidance note is a professional or personal standard for the purposes of RICS Rules of Conduct.

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In regulatory or disciplinary proceedings, RICS will take account of relevant guidance notes in deciding whether a member acted professionally, appropriately and with reasonable competence. It is also likely that during any legal proceedings a judge, adjudicator or equivalent will take RICS guidance notes into account.

RICS recognises that there may be legislative requirements or regional, national or international standards that take precedence over an RICS guidance note.

## Document status defined

The following table shows the categories of RICS professional content and their definitions.

### Publications status

Type of document	Definition
<i>RICS Rules of Conduct for Members</i> and <i>RICS Rules of Conduct for Firms</i>	These Rules set out the standards of professional conduct and practice expected of members and firms registered for regulation by RICS.
International standard	High-level standard developed in collaboration with other relevant bodies.
RICS professional statement (PS)	Mandatory requirements for RICS members and RICS-regulated firms.
RICS guidance note (GN)	A document that provides users with recommendations or an approach for accepted good practice as followed by competent and conscientious practitioners.
RICS code of practice (CoP)	A document developed in collaboration with other professional bodies and stakeholders that will have the status of a professional statement or guidance note.
RICS jurisdiction guide (JG)	This provides relevant local market information associated with an RICS international standard or RICS professional statement. This will include local legislation, associations and professional bodies as well as any other useful information that will help a user understand the local requirements connected with the standard or statement. This is not guidance or best practice material, but rather information to support adoption and implementation of the standard or statement locally.

# Glossary

<b>Alienation clause</b>	A clause in a mortgage contract that requires full payment of the balance of the mortgage, at the lender's discretion, if the lease is sold, assigned, sublet or the property is shared.
<b>Assumption</b>	As defined by <a href="#">RICS Valuation – Global Standards (Red Book Global Standards)</a> , VPS 4.8, an assumption is made where it is reasonable for the valuer to accept that something is true without the need for specific investigation or verification.
<b>Collective leasehold enfranchisement</b>	The process whereby a group of individual qualifying lessees can acquire the freehold in a building as allowed under the <a href="#">Leasehold Reform, Housing and Urban Development Act 1993 (as amended)</a> .
<b>Commonhold and Leasehold Reform Act 2002</b>	Legislation that amended the <i>Leasehold Reform, Housing and Urban Development Act 1993</i> , introducing the concept of commonhold ownership and effectively extending the rights of leaseholders to purchase and influence management of the freehold.
<b>Comparable</b>	The current edition of <a href="#">Comparable evidence in real estate valuation</a> , RICS guidance note, defines a comparable as an item of information used during the valuation process as evidence to support the valuation of another, similar item. Comparable evidence comprises a range of relevant data used by the valuer to support a valuation.
<b>Covenant</b>	An agreement, contract, or written promise between two individuals that frequently constitutes a pledge to do or refrain from doing something.
<b>Enfranchisement</b>	A statutory right or privilege granted to a person or group by a government.
<b>Ground rent</b>	Regular payments made by a holder of a leasehold property to the freeholder or a superior leaseholder, as required under a lease.
<b>Lease extension</b>	The process by which a qualifying lessee can extend the leasehold term on a flat under the <i>Leasehold Reform, Housing and Urban Development Act 1993</i> (as amended). Under the 1993 Act, the standard extension is 90 years with a peppercorn ground rent; that is, nil.
<b>Leasehold enfranchisement</b>	The process of buying the freehold of a house, where it qualifies, as enshrined in the <a href="#">Leasehold Reform Act 1967</a> .

<b>Leasehold reform</b>	This term relates collectively to the rights granted to leaseholders under the <i>Leasehold Reform Act 1967</i> (as amended) and the <i>Leasehold Reform, Housing and Urban Development Act 1993</i> (as amended) to acquire overriding interests, extend their leases or take control of the management of their building according to the circumstances of their ownership and provisions of the relevant legislation.
<b>Market value</b>	As defined by Red Book Global Standards, VPS 4.4, this is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing, and where the parties have each acted knowledgeably, prudently and without compulsion.
<b>Marriage value</b>	This is defined in the <i>Leasehold Reform, Housing and Urban Development Act 1993</i> (as amended) and by legal precedent, and is the difference in the value of the interests of the owners before and after the exercise of the leaseholder's rights under the relevant statute. The statutes proscribe marriage value for unexpired terms in excess of 80 years. (See <b>Leasehold reform</b> .)
<b>Relativity curve or graphs</b>	Valuers use such graphs to determine the value of a hypothetical leasehold interest in a property, compared to its freehold value. The graphs express the value of a dwelling held on an existing lease at any given unexpired term divided by the value of the same dwelling in possession to the freeholder, expressed as a percentage.
<b>Reserve or sinking fund</b>	An amount of money that is set aside to cover any major work needed on a property in the future.
<b>Service charge</b>	A sum levied by landlords to recover the costs they incur in providing services to a building.



# 1 Introduction

It **has been estimated** that around one-fifth of the total housing stock in England comprises leasehold properties, with short- and medium-term leases becoming increasingly common as original terms decrease. The difficulty facing some surveyors, lenders and the general public is a lack of understanding of the depreciating nature of leasehold tenure, so there is a need to increase awareness.

Freeholds or virtual freeholds – that is, very long leases – remain the dominant form of tenure in the market. The **Leasehold Reform Act 1967** and the **Leasehold Reform, Housing and Urban Development Act 1993** are generally available to leaseholders to secure a lease extension, leasehold enfranchisement, or collective leasehold enfranchisement. It is essential that valuers are aware of the different provisions in this legislation relating to houses and flats.

The costs of leasehold property occupancy are factors that can affect value, and should be appropriately reflected in advice to clients. These costs can be appreciable and may include service charges, ground rent, major works costs, and event fees such as those paid for permission for alterations or on alienation. Valuers should make appropriate enquiries before reporting the level of these costs, if any, and make any relevant allowance in their valuations; mandatory requirements for these enquiries are set out in **RICS Valuation – Global Standards (Red Book Global Standards)**, VPS 2.

Increasingly, the clauses in some leases relating to ongoing costs are being recognised as having a material effect on value. Some modern leases – those granted since around 2005 – may contain onerous ground rent clauses while others provide for event fees and estate charges, all of which might affect the mortgageability, the costs of occupation and consequently the value of the property.

Adverse publicity in recent years – regarding onerous ground rents in particular – demonstrates that issues relating to leasehold are prominent in the public eye. Valuers have a professional duty to give proper consideration to matters affecting leasehold value.

The UK government set out summary proposals committing to leasehold reform **in a written statement of January 2021** and **the Queen's Speech in May**. At the time of publication of this guidance note, the UK government has not produced a detailed timetable for proposed reforms, so RICS members should meanwhile follow this guidance and other relevant standards, giving due consideration to the market and current statute.

A member should collect as much information regarding the lease terms as possible, as detailed in **section 2.6**, relying on assumptions only where they are reasonable and where detailed enquiries have failed; on the subject of assumptions, see Red Book Global Standards, VPS 4, sections 8 and 9, and also UK VPGA 11 in **RICS Valuation – Global Standards: UK national supplement 2018 (Red Book: UK national supplement)**. The member must bring the required levels of independence and objectivity to bear on individual valuation instructions, applying professional scepticism to information and data where it is to be relied on as evidence, in accordance with Red Book Global Standards, PS 2, paragraph 1.5.

Reliance on assumptions, coupled with lenders' adoption of automated mortgage processing, has in some instances placed those lenders at risk, and therefore their customers as well. When assumptions are made, reference back to the valuer often happens only at a late stage in the transaction, resulting in unnecessary delays. At the same time, valuers should avoid routinely placing responsibility on

conveyancers for obtaining information that is already in the public domain or that could have been ascertained through appropriate enquiries.

A note of those enquiries, the outcome and the exact source of the information should be documented in the valuer's site notes. If assumptions are made this should be clearly stated in the valuation report, where the relevant lender format allows. If not, the valuer should ensure – through the terms of engagement or other overarching document relating to the valuation services to be provided – that the assumptions they have made, or had to make, are clear.

RICS members should also consider the impact on value caused by cladding and external wall systems when valuing certain types of leasehold property. Remediation costs can be significant and could potentially have a material effect on value. RICS members should be fully aware of the latest government and professional guidance – such as the current edition of **Valuation of properties in multi-storey, multi-occupancy residential buildings with cladding**, RICS guidance note – as well as who is legally liable for the cost of remediation, and consider current, ongoing and potential future costs in their valuation.

## 1.1 Scope

This guidance note focuses on the valuation of leasehold interests expressly for secured lending purposes. It supplements the overall valuation standards laid down in Red Book Global Standards, including the UK national supplement. Detailed valuations for leasehold reform purposes are outside the scope of this guidance note.

Attention is drawn to the UK government's 2021 announcements of proposed leasehold reform, as referred to above. Each of the subsequent chapters should be read in that context.

This document is a guide to the valuation of leasehold properties for secured lending purposes, in particular those that have a diminishing lease term of less than 80 years remaining, when marriage value becomes payable and, in many markets, there starts to be a material impact on market value.

It is not a guide for the valuation of properties for leasehold reform purposes, which is a specialist area and should only be undertaken by those with relevant experience. Where remaining lease terms are longer than 100 years, very little impact on value is assumed compared to a long lease or a freehold property, although this will depend on the terms of the lease and the nature of the particular market where the property is situated.

This guidance note is directed at the valuation of properties that may qualify for rights under leasehold reform legislation. Please note that not all properties qualify; for example, those in shared ownership. In this event, assumptions regarding leasehold properties may not apply.

This document attempts to highlight the issues involved in valuing leasehold properties for secured lending purposes in conjunction with the lender requirements; the focus is on the challenges faced when valuing flats in line with the restrictions of a typical lender's valuation reporting policy.

This guidance note is applicable when lease lengths are 55 years or longer. Where the remaining lease term is less than 55 years, lenders may have specific instructions, often due to restricted mortgageability, of which RICS members should be aware.

## 1.2 Effective date

This guidance note is effective from 1 July 2021.

## 2 Background

**Note:** Consideration of lease factors by a valuer can only be based on the information that is available and readily accessible to them. It is not necessary for the valuer to make detailed enquiries into legal, maintenance or planning matters as a part of the mortgage valuation process. Leasehold data including the unexpired lease term, ground rent and any further relevant information should be sourced verbally on the day of inspection or beforehand from the vendor, the occupier or the selling agent, as applicable. If the unexpired term of the lease is unavailable, valuers should consider whether it is appropriate to supply a valuation without at least obtaining the title extract or register view from HM Land Registry. Attention is drawn to Red Book: UK national supplement – specifically UK VPGA 11.5 – in respect of assumptions and special assumptions.

### 2.1 Lender expectations

Lender expectations about the valuation of leasehold properties are changing: they increasingly want to be provided with more information in order to understand the risks associated with lending on leasehold properties in general, and leasehold flats in particular. Valuers should be prepared to help, but should be careful not to venture outside their area of knowledge or expertise, or go beyond the agreed terms of engagement.

The specific lender policy for leasehold properties should always be the first point of reference for a valuer. However, where a lender is prepared to make a mortgage advance on a property with a very short lease term remaining, valuers should obtain specific guidance from the lender as to the basis on which it wishes the property to be valued. In any event, the valuer is not expected to extend the scope of an inspection beyond the requirements laid down in Red Book Global Standards, but should bear in mind the considerations set out in this guidance note and record any findings, including but not limited to matters affecting value such as:

- remaining lease term
- ground rents and rent review provisions
- ongoing maintenance or service charges
- legislation referring to fire safety and health and safety
- the cost or potential cost of repair works
- restrictive covenants, and
- planning use.

### 2.2 Red Book requirements

Red Book: UK national supplement, UK VPGA 11 – ‘Valuation for residential mortgage purposes’ – introduces an assumption that, unless information is provided to the contrary, a valuer can assume an unexpired term of 85 years for the subject property.

The rationale behind this came from the [Commonhold and Leasehold Reform Act 2002](#). This legislated that marriage value is to be ignored where, at the valuation date to determine the enfranchisement price

or the new lease premium, the existing lease term exceeds 80 years. Other assumptions regarding lease terms are also detailed in UK VPGA 11.

However, these assumptions are provided only as a basis on which to report value where lease terms cannot be established after undertaking a reasonable level of research, as detailed in this guidance note by the note at the beginning of [chapter 2](#) and in [section 2.6](#). It is expected that a valuer should make reasonable efforts to establish lease details, and a routine dependence on the assumptions is to be avoided. Assumptions should only be relied on where appropriate enquiries have been reasonably pursued but failed to elicit information.

**Note:** The 85-year assumption is not intended to indicate that properties with leases below this figure are not readily marketable or mortgageable, or that they have no value. Many mainstream mortgage lenders' criteria permit loans on leases with as few as 55 years unexpired.

## 2.3 Regulation and legislation

The increasingly tight regulations in the residential property sector and the sometimes substantial maintenance and other charges that leasehold properties may incur can potentially have a material impact on value. Maintenance and repair charges can run into tens of thousands of pounds and have particular implications for buildings in low-value areas where they can amount, in relative terms, to a higher proportion of the property's capital value.

Members' attention is drawn to the Building Safety Bill, which at the time of writing is before Parliament, as well as the [Fire Safety Act 2021](#), and they should be aware of the effect of this legislation on value where works are required.

Valuers can account for the condition of a leasehold building's communal areas in a valuation by using comparable evidence of blocks in a similar condition. However, it should also be common practice to undertake further enquiries of an occupier or agent as to any proposed or scheduled works, where properties seem in a condition indicating that maintenance is due. When valuing a leasehold property, in particular a flat, it is important not just to consider the property in isolation but to factor in elements such as the apparent condition of other units in the block, common parts and grounds.

Landlord and tenant legislation requires the freeholder to comply with various regulations relating to the common parts or fabric of a building containing leasehold properties. The valuer should therefore be aware of the main principles of regulations – as set out in, for instance, the current edition of the [Service charge residential management code](#), RICS code of practice – because failure to comply could result in the property becoming unsuitable for occupation. This may be particularly relevant in relation to buy-to-let properties: see the current edition of *Valuation of buy-to-let and HMO properties*, RICS guidance note.

Failure to comply may also result in charges being passed on to the leaseholders, in order for the common parts to be upgraded to meet these regulations. In turn, this could have an impact on the capital value of the property and its suitability for mortgage purposes. The valuer, however, is not expected to be responsible either for obtaining the documentary confirmation that the property complies with the relevant regulations, or for identifying any shortcomings that may exist at the property unless these are readily apparent during the inspection.

## 2.4 Building elements

Elements of a building naturally age at different rates. Where a valuer observes or suspects that maintenance work is due, reasonable and documented enquiries – of the kind detailed in this guidance note by the note at the beginning of [chapter 2](#) and in [section 2.6](#) – should be made. Following these enquiries, the valuer should highlight relevant matters in the valuation report, where the reporting requirements of the lender allow this to be done; if they do not but the issue is material to the valuation, the valuer should consider how the lender's attention might be drawn to this. The conveyancer or lender's legal adviser can then verify whether any scheduled maintenance works are due and who is responsible for paying, because this may affect the capital value of the property.

Valuers should not automatically rely on general assumptions unless they have undertaken appropriate and reasonable enquiries with the selling agent, vendor or occupier first.

## 2.5 Matters affecting value

Individual influences on value may be notified to the valuer by conveyancers at some point during the valuation process. These are covered elsewhere in this guidance note, and include:

- diminishing lease terms ([chapter 4](#))
- restrictive covenants in the lease ([chapter 5](#))
- planning agreements ([chapter 5](#))
- compliance with fire safety and health and safety regulations ([section 2.3](#))
- maintenance works ([section 6.1](#))
- service charges ([section 6.1](#)), and
- ground rents ([section 6.2](#)).

Valuers should note that some lenders have adopted automated underwriting processes, which means that if information is provided after valuation – for example, as a post-valuation query (PVQ) – subsequent adjustments to valuation or to their opinion of suitability for mortgage purposes may not be possible. RICS members should therefore verify as much information as possible before submitting the valuation because they may not have an opportunity to amend it thereafter.

## 2.6 The inspection

When inspecting a leasehold property to conduct a valuation for secured lending purposes, the valuer must comply with the requirements of Red Book Global Standards and the UK national supplement. In addition to this, it is expected that the valuer will in most circumstances attempt to obtain the following information from the agent, owner or occupier of the property, where relevant:

- the remaining term of the lease and whether it has been extended
- any known costs for a lease extension
- ground rent amount, review period, escalation methodology and so on
- the level of the service charge and whether there is a sinking fund or reserve fund
- the existence of any event fees
- any foreseeable costs such as planned maintenance, repair works or major works proposals

- for multi-storey flats where the presence of potentially combustible materials is suspected in the wall system, whether intrusive investigations have been carried out and whether future remedial works have been proposed, including the need for temporary measures such as waking watch patrols
- whether a fire risk assessment has been completed and whether any significant actions have been identified, and
- the identity of the freeholder and the existence of a managing agent or management company.

The valuer is advised to seek this information as early as possible in the process, and ensure that their findings are properly recorded.

In addition, a valuer should use local knowledge and any readily available public information to highlight areas of concern. These could include, for instance, a general awareness that the block has issues with poor maintenance or management and is subject to major works costs, or high-profile press coverage of onerous lease clauses – as discussed in [chapter 6](#) – affecting the particular development.

It is only in the event that no such information is available that a valuer should consider making standard assumptions, as laid out in the secured lending protocol of the UK national supplement.

## 3 Legal responsibilities

Leases on flats typically provide for the building owner to be responsible for maintaining and insuring the structure and common parts of a block of flats and for providing relevant services. The costs to the building owner of this are, in the main, recoverable as a service charge from leaseholders.

Although valuers are not expected to be experts in the management of residential property – including blocks of flats – this does not discharge them from their responsibilities, and they should be aware of the costs that could be incurred by leaseholders and the impact these may have on value. This has been repeatedly demonstrated by disputes surrounding the replacement of cladding and other remedial actions following the Grenfell Tower fire in 2017.

Landlords' legal requirements include the following, although this is not an exhaustive list:

- fire risk assessment
- health and safety
- control of asbestos
- gas safety
- electrical equipment safety, and
- alarms for smoke, heat, carbon monoxide and so on.

While valuers are not expected to have specialist knowledge of the requirements imposed on property managers, any obvious deficiencies found when inspecting common parts may indicate a landlord's failure to fulfil their obligations. If evidence in the public domain suggests a lack of compliance, valuers should consider the impact on value and marketability of the subject property, and its suitability for mortgage purposes.



## 4 Diminishing lease terms

Leasehold properties in general are depreciating assets for both the leaseholder and lenders. All other things being equal, this means that the leasehold value decreases as the unexpired term reduces. It is the valuer's responsibility to properly consider the impact of the length of the lease term on the market value of a property.

In the absence of lease information in the originating instruction, it is the valuer's responsibility to investigate lease details to the extent set out in this guidance note, specifically in the note at the beginning of [chapter 2](#) and in [section 2.6](#). Only after the required enquiries have been made of owners and agents can the relevant assumptions be made. Where the leasehold term is provided, valuers should treat this with some caution and be conscious of the accuracy of the information.

In preparing the valuation for mortgage purposes, and in the absence of lender guidance, some provisions of the [Leasehold Reform Act 1967](#) and the [Leasehold Reform, Housing and Urban Development Act 1993](#) may not apply. The following assumptions can then be made.

- Where the lease of a flat is extended under the 1993 Act it will be extended by 90 years, and where the lease of a house is extended under the 1967 Act it will be extended by 50 years; in both cases, the ground rent may be reduced to a peppercorn, that is, nil.
- The existing lease is enfranchisable.
- The valuation includes leaseholder's improvements.
- There are no intermediary leases.

**Note:** In approaching the valuation, the valuer can agree terms that include making a special assumption that a lender in possession has the right to serve notice to extend the lease or purchase the freehold. This means that, in the event of default, a lender would be assumed to have the right to operate in the same way as other market participants, and that this would have no impact on value. In practice, a lender is unlikely to exercise that right, as this will incur costs and increase the outstanding mortgage balance.

The valuer should also be aware of a lessee's right to assign the benefit of their notice to a new leaseholder; appropriate enquiries should be made of owners or agents in that respect. However, this special assumption should not be used when providing a market valuation on, for example, a shared-ownership property or one owned by the Crown; such leases are not held by tenants qualifying to extend under either the 1967 or 1993 Act, and consequently they cannot effect a lease extension or participate in a collective enfranchisement. However, this will only affect a relatively small proportion of properties.

Consideration should be given to whether the property lies in an area popular with investors rather than owner-occupiers as well. For example, if investors in such a location were to target properties with shorter lease terms in order to benefit from higher relative yields, values may become distorted. It might also be necessary to adopt different approaches in areas with fewer owner-occupiers, for example student residential areas, or when valuing houses as opposed to flats. The relative costs of a lease extension should be understood by valuers, as these may influence demand for leasehold properties in a particular location or sector of the market.

Although a leasehold reform valuation is outside the remit of valuation for secured lending purposes, valuers should be familiar with the broad principles of enfranchisement and lease extension outlined below if they are to use the methods detailed in this guidance note. In the case of flats, the premium to be paid for the new lease, according to Schedule 13, Part II of the 1993 Act (as amended), is the total of:

- ‘the diminution in the value of the landlord’s interest in the [...] flat’; that is, the difference between the value of their interest now with the present lease and the value of their interest after the grant of the new lease with the extra 90 years; note, these values are based on an assumption that there is no statutory right available to the subject property to extend the lease
- ‘the landlord’s share of the marriage value’, although this only applies to leases with fewer than 80 years unexpired, and
- compensation for loss arising from the grant of the new lease.

For a more detailed understanding and for information regarding the 1967 Act, reference should be made to the current edition of [Leasehold reform in England and Wales](#), RICS guidance note. This may also be subject to update following the UK government’s 2021 announcements in respect of leasehold reform, referred to in [chapter 1](#) of this guidance note.

# 5 Restrictive covenants and planning agreements

A restrictive covenant can have a significant and substantial impact on the use and thus the value of a property. It is important to consider the restrictions and obligations to which the property is subject, the consequences if these are not fulfilled, and any associated impact on value.

At the inspection of a leasehold property, the valuer should make enquiries with the occupiers and agents – as per the note at the beginning of [chapter 2](#) of this document as well as [section 2.6](#) – to establish whether the property has been altered since its original construction, and whether its use and occupation breach any restrictive covenant.

Although lesser covenants – such as not keeping pets, not causing nuisance and so on – are unlikely to have a material impact on value, if any impact at all, more onerous covenants can have an adverse effect.

Typically, an alienation clause prohibiting subletting could adversely affect value in a market with a significant proportion of buy-to-let investors in which there is demand to let on assured shorthold tenancies.

Where breaches of covenants are identified, valuers should consider whether these materially affect value. Where no such details are available or readily apparent, an assumption that there are no onerous conditions in the lease and that all covenants have been fulfilled may have to be made, pending legal advice to the contrary.

In the event that the valuer has concerns about the potential for onerous covenants or a possible breach, whether through their local knowledge or the provision of limited information, the valuation may need to be withheld until the full details and their acceptability to the lender are established through further reference to legal advisers.

Meanwhile, although planning agreements are not exclusively applied to leasehold tenure, some modern developments have restrictions on occupation, with resale conditions imposed by the local authority. Examples include live-work units, or where occupation and resale are restricted to certain types of individual: for example, key workers, first-time buyers, or those in certain income bands or resident in a particular local authority area. Valuers should also be aware that some developments have mixed tenures, such as shared ownership or affordable rent, which might affect value.

# 6 Other factors affecting value

## 6.1 Service charges and reserve or sinking funds

One of the major issues facing leaseholders is the division of responsibility for maintaining their property, which may have an impact on value. Generally, the primary responsibility for the insurance, maintenance and repair of a block of flats, including the common parts, lies with the freeholder, while the leaseholder is responsible for the maintenance of their own flat. The leaseholder makes a covenant – that is, a contract – under the lease to pay a reasonably apportioned share of the costs of maintaining and running the building, in the form of the service charge. The freeholder is obliged to ensure that leaseholders comply with their obligations, which is beneficial to all.

Service charges are collected for the maintenance, insurance and repair of a building and the communal areas, plus the employment of staff and management of the property. Service charges can vary each year, depending on the expenditure due for that period. Most modern leases allow for the landlord to collect service charges in advance, repaying any surplus or collecting any shortfall at the end of the year.

By contrast, a sinking or reserve fund is established over a period of time to provide a capital sum to contribute to, pay for and mitigate any planned or extraordinary future expenditure.

Most private blocks of flats have a reserve or sinking fund. However, where a building is poorly managed there may be no reserve fund per se, or insufficient money in it for future maintenance work. In this case, leaseholders may be required to make payments in the short to medium term. A service charge contribution that appears to be less than the norm for a property of its type is an early warning that there may be no reserve fund in place, or that only an unreasonably low portion of the charge is going into the fund. This should make the valuer consider whether there is any adverse impact on the market value; if they are concerned, then they may wish to seek further information.

In local authority blocks of flats there are no reserve funds and, while some relief may be available, leaseholders are generally responsible for all costs, payable during or on completion of repair or improvement works. This may affect marketability and value.

Major works can include external and internal redecorations and replacement of lifts, windows, services and the roof. Valuers should consider the condition of such items during their inspection because this may indicate whether major works are due. In inspecting a block, valuers may wish to be aware that the age and construction type can affect value: for example, 1930s mansion blocks can be more expensive to repair because of their communal heating systems. Other factors affecting value include shared facilities such as gyms, gardens, swimming pools and lifts.

Where information is available, valuers should consider the cost of service charges, sinking funds and any major works due, along with their impact on the market value, which in turn would affect the property's suitability for mortgage purposes. If this information comes to light as a result of a PVQ after the initial valuation has been submitted, the valuer may reconsider their initial conclusion in light of the new evidence.

Where no such details are made available after rigorous enquiries, an assumption that there are no onerous conditions in the lease may have to be made, pending legal advice to the contrary. In the

event that the valuer has concerns about future costs associated with the lease because of their local knowledge, the provision of limited information or their inspection, the valuation may need to be withheld until the full details and lender acceptability are established through reference to legal advisers.

## 6.2 Ground rents

Generally, a lease includes provisions for the payment of ground rent, with periodic reviews thereof. Typical sums range from a peppercorn to a few hundred pounds per annum. In some leases, the ground rent provisions are onerous, which means that the sums payable are significant and may have an adverse effect on the market value and saleability of the property. Ground rent reviews are generally either fixed or escalating.

There are four factors regarding ground rents that may affect value. These are:

- lease length
- level of ground rent compared to the value of the property
- frequency of reviews, and
- basis of review; for example, in line with retail price index, doubling or so on.

The lease will specify when the ground rent is to be reviewed, on what basis, and by how much it is to increase. Where this information is made available, or is revealed when making the enquiries detailed in the lists in [sections 2.1](#) and [2.6](#) of this guidance note, it is the responsibility of the valuer to assess whether the provisions have an effect on market value.

If the effect is adverse, the valuer should refer to lender policy and, where it is acceptable for lending, should calculate the adjustment to reach the appropriate market value. Where no such details are available, the valuer may have to make an assumption that there are no onerous conditions in the lease, pending legal advice to the contrary. Should the valuer have concerns about the acceptability of the ground rent thanks to their local knowledge or the provision of limited information, the valuation may need to be withheld until the full details and their acceptability to the lender are established by reference to legal advisers.

When determining whether a lease term is onerous, valuers should consider indicators such as:

- existence of escalator clauses
- frequency of reviews
- level of the ground rent compared to value
- basis on which a review is made
- length of the lease, and
- lender policy, where provided.

Generally, ground rents that are fixed at a low figure or set at a peppercorn rate are considered reasonable. In areas such as central London and in some new developments and office conversions though, concerns have been raised around the reasonableness of ground rents, so valuers should be aware of any such issues in their areas.

The action that a valuer takes in the event of a concern over a lease term is dictated by their own knowledge of the local market and the requirements laid down by the instructing lender. Valuers should be specifically aware that certain types of development can attract onerous lease terms, such as offices

converted to residential blocks or developments built since around 2005, so they should be particularly aware of the effect on value and avoid making assumptions.

There is no simple definition of 'onerous', and the effects on value and even suitability for mortgage depend on the actual terms of the lease, the local market and lender policy. Many modern residential leases – that is, those drawn up since 2005 – are increasingly complex, and valuers should not be afraid to request legal interpretation of any specific terms whose implications are not easily discernible. Recent publicity has shown that value can be significantly affected by these, and they can also influence consumer confidence.

Valuers should be aware of the costs of buying out the onerous clause, which can sometimes be high. Particularly where leases are proposed to be, or have already been, extended outside the scope of the **Leasehold Reform Act 1967** or the **Leasehold Reform, Housing and Urban Development Act 1993** – say, by private agreement with the building owner – the terms can be negotiated and onerous clauses inserted. Valuers should then make additional enquiries before valuation if they are aware that an extension or enfranchisement is to be carried out, or has been carried out without the protection of the 1967 or 1993 Acts.

### 6.3 Event fees

Sometimes, investment value has been created for the freeholder by drafting leases that provide them with a secure, and escalating, rental income stream; this occurs most often on recently built developments, although not exclusively. Investment value can also be created by including provisions to collect fees for permission for alterations or on alienation, such as a fee for permission to extend a property or a sum to be deducted from sale proceeds, which are known as event fees.

While such clauses are generally reasonable and provide only for the landlord to be compensated for services provided, where details are made available or given in response to appropriate enquiries – as per the note at the beginning of **chapter 2** and **section 2.6** of this guidance note – the valuer should consider the lease terms and reflect the impact, if any, on market value and thus the property's suitability for mortgage in their valuation report.

Where a valuer is aware of issues with a particular development or block, they may wish to refer these back to the instructing lender before making a valuation.

### 6.4 Additional factors affecting value

Additional factors that affect value mainly relate to leasehold blocks of flats rather than individual houses. The current edition of the **Service charge residential management code**, RICS code of practice, applies only to residential leasehold properties in England, but practitioners operating in other parts of the UK are encouraged to follow the best practice guidelines it contains.

The code has been prepared to promote desirable practices in respect of the management of residential leasehold property. Valuers should therefore be aware of the compliance implications of the code and the impact they may have on market value. Note that, in addition to recent government leasehold reform announcements referred to in **chapter 1** of this guidance note and more general market changes, the code is under review at the time of publication.

# 7 Guidance for conducting a mortgage valuation of a leasehold property

This chapter shows how to conduct a mortgage valuation for a leasehold property subject to a typical but medium or short lease term on the basis of market value.

## 7.1 Analysing comparable transactions to value diminishing leases

Lease length – or more specifically the length of the unexpired term – is one of the more significant factors affecting the market value of a property. Valuers need to have an appreciation of the relative values of leases at various lease lengths; that is, their relativity.

## 7.2 Analysis of evidence

In analysing comparable evidence, valuers should refer to the current edition of **Comparable evidence in real estate valuation**, RICS guidance note.

As always, the best evidence consists of similar properties with similar lease terms, of a similar type and size and in the same area as the subject property. However, care should be taken when considering transactions on properties with a short remaining lease term because a simultaneous lease extension may have been factored in to the value of the sale. If the comparable sales are dissimilar physically and in terms of tenure, the valuer needs to make appropriate adjustments for both characteristics. The best comparable is the one that requires least adjustment; however, the factors in Figure 1 should also be considered.

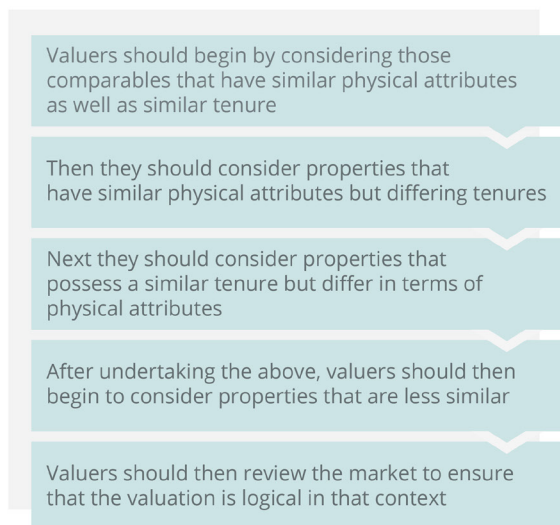


Figure 1: Comparables to consider when making a mortgage valuation of a leasehold property (source: based on image supplied by Kinleigh Folkard & Hayward)

When there is recent evidence of market sales with shorter leases, this is of greater relevance than using relativity or a leasehold value calculator. When collating comparable evidence, valuers should make enquiries of sales agents as to the leasehold terms, and avoid assuming comparable evidence has long lease terms because this can lead to inaccuracies in valuations.

It is therefore important to identify comparables' lease lengths and other terms when valuing leasehold properties; some mainstream lenders do so as policy. In cases where it is not possible to verify the lease terms and other provisions of comparables, common sense as well as local knowledge can be adopted. For example, it would be sensible to assume that a new-build property will not have a short lease term remaining, while a leasehold property dating from the 1970s is unlikely to have more than 85 years left on the term.

### 7.3 Understanding leasehold relativity

A relativity curve is a graph prepared for leasehold reform practitioners that indicates relative leasehold value at any point in a lease term compared to a freehold value. Some present the values on the assumption that the leaseholder does not have the right to extend their lease, while others assume they do. However, they may factor in other influences on leasehold valuation such as ground rent.

Figure 2 shows an illustrative relativity curve; note that this should not be used in a valuation.

There are several kinds of relativity curve available; in sourcing a graph, valuers should understand how reliable the data is, and also be aware of contemporary case law.

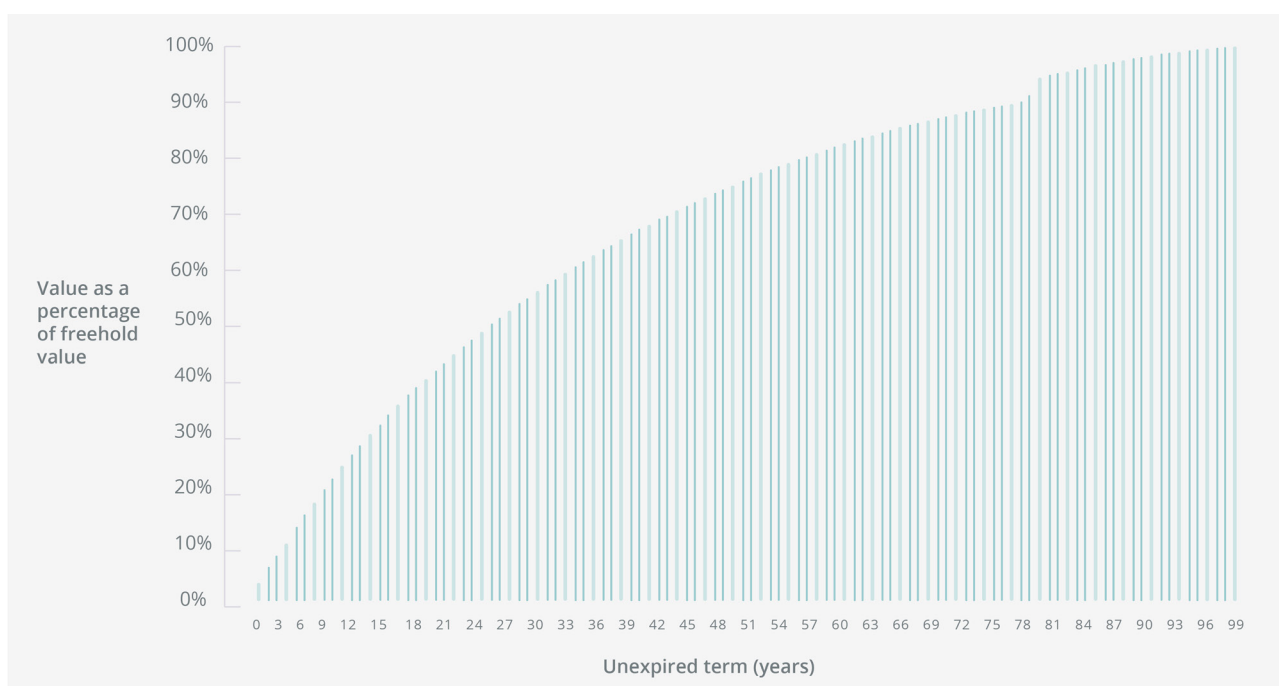


Figure 2: Illustrative relativity curve. Note: this is not an actual relativity curve and should not be interpreted as such; RICS and Kinleigh Folkard & Hayward accept no responsibility for its use (source: based on image supplied by Kinleigh Folkard & Hayward)



## 7.4 Applying leasehold relativity

The operation of the market will determine leasehold relativity. Suitably experienced valuers will understand and be able to interpret the market dynamics in their own locality and so have confidence in the particular relativities to be used in adjusting the comparable evidence.

Comparing data from different unexpired lease terms requires the valuer to adjust these to a common reference point, for example a so-called virtual freehold. To do this, the relativity graph can be used in reverse.

For example, if a property with an unexpired lease term of 65 years has a relativity of 86%, then a valuer can convert a comparable with this lease term to a hypothetical freehold using the factor  $100/86$ . While this exercise may not follow the exact process used by leasehold enfranchisement experts, if it is applied consistently to all the comparable sales and adjusted for the different lease terms, it provides a guide to the valuation range as though the various properties all have a long lease equivalent. The market value can be considered from this adjusted range, using the relativity graph to adjust the virtual freehold value back to reflect the actual lease term of the subject property.

**Note:** The hypothetical freehold calculation can provide the valuer with an inflated virtual freehold value, which may need to be taken back to provide a realistic market value for a property with any given lease term. It also does not take into consideration other influences on value such as the level of ground rent, which may need to be factored in or considered separately, as in the following example.

The subject property is a two-bed purpose-built flat with 70 years' unexpired lease term. The three comparable properties in Table 1 are of the same type, style, size and condition in the same location, and were all sold within the past month. They vary only in the unexpired lease term.

	Comparable 1	Comparable 2	Comparable 3
<b>Unexpired lease term</b>	65 years	55 years	72 years
<b>Relativity</b>	86%	80%	92%
<b>Sale price</b>	£172,000	£162,000	£186,000
<b>Calculation</b>	$£172,000/86 \times 100$	$£162,000/80 \times 100$	$£186,000/92 \times 100$
<b>Virtual freehold value</b>	<b>£200,000</b>	<b>£202,500</b>	<b>£202,200</b>

Table 1: Comparable calculations for virtual freehold value

It is important to analyse the market evidence objectively before adjusting the value of the subject property. Table 1 provides a valuation range of £200,000–£202,500, and on this basis the subject property is worth, say, £201,000 on a virtual freehold basis.

In this example, the unexpired lease term of 70 years has a relativity of 91%. To convert the valuation to reflect this, the following calculation is made:

$$\mathbf{£201,000 \times 91/100 = £182,900}$$

This points to a valuation for the subject property of, say, £183,000.

It should be noted that the percentages and figures given are purely an example and do not relate to an actual relativity graph. The valuer should source, test and monitor an appropriate graph. In addition, bearing in mind the simplicity of this approach, valuers should also always sense-check the outcome of such a valuation calculation against known market transactions and other information.

Valuers will appreciate that the market value of a lease could also be approached by assessing the corresponding extended lease value then deducting the costs for extending the lease, including a margin for risk, time and uncertainty. Again, this simplistic approach will not be applicable in all circumstances, and will need to be sense-checked against known market information.

Publicly available leasehold calculators do exist. However, valuers should be aware that these have a varying degree of accuracy and should only be used as a cross-check in exceptional circumstances; it should be appreciated, for example, that they do not take into account other terms, such as escalating or onerous ground rents. Where in-house calculators are used, valuers should be familiar with their reliability and satisfy themselves that the output is reasonable for the property concerned. In any event, all valuations for secured lending purposes must be conducted in accordance with Red Book Global Standards and UK national supplement.

It is likely that a valuer will use a combination of the above methods together with their skill and judgement to arrive at their final opinion of market value; they should record their thought processes in their documented justification for the final valuation conclusion.

When analysing comparables within the same block, valuers should be aware that even sales in that building may not have the same lease terms – particularly where some leaseholders have negotiated the extension of their leases outside the terms of the relevant legislation, which may be on less advantageous terms.

The best market evidence comprises similar properties with similar lease terms, and it should be noted that in some locations the market differentiates between longer and shorter leases less than might be expected. In effect, the full costs of extension are not necessarily reflected in the price agreed.

## 8 Summary

The valuation of leasehold property is a complex matter that involves assessing a combination of factors before arriving at a conclusion. Where value-influencing details are not readily available or provided on the instructions, appropriate investigations should be made to establish them. The standards and guidance relevant to such investigations are contained in Red Book Global Standards, as augmented by the UK national supplement.

It has become increasingly clear that valuers can no longer rely on assumptions to the extent that has historically been the case, and that there are several topical issues with leasehold tenure that will need the valuer's attention and consideration when valuing a property. These include, but are not limited to, ground rent and review provisions, lease length, repair costs, service charges and restrictive covenants. All of these have the potential to affect value materially, and should therefore be taken into account during the valuation process.

When considering the available information, it is the responsibility of the valuer to decide whether they can submit a valuation report with confidence, in particular where critical additional information regarding the lease – including the term, the ground rent, service charge provisions and its covenants generally – is absent. Only then can the use of the standard assumptions laid down in the UK national supplement be considered, and they should be used solely where they are realistic and reasonable. This approach should be similar to that taken with essential repairs or requests for essential reports. If a reliable valuation cannot be provided without further information or advice, the valuer may consider it prudent to obtain that advice before ascribing a value to the property.

In all events, a valuation conducted for secured lending purposes must comply with the requirements and standards in the current Red Book Global Standards and Red Book: UK national supplement.

## Delivering confidence

We are RICS. Everything we do is designed to effect positive change in the built and natural environments. Through our respected global standards, leading professional progression and our trusted data and insight, we promote and enforce the highest professional standards in the development and management of land, real estate, construction and infrastructure. Our work with others provides a foundation for confident markets, pioneers better places to live and work and is a force for positive social impact.

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