



QUESTIONS AND ANSWERS ON LEASE EXTENSIONS

- 1. Q. What if I prefer to go to court for a lease extension?
A. *You will only get 90 years and will have to meet the costs of valuation which may well set a higher premium than we would propose. You will also have to meet all legal expenses including those of the freeholder.*

- 2. Q. Would a shorter lease extension, say to 100 years, be cheaper?
A. *Probably slightly less but, as with the original 125-year leases, it only postpones the problem and duplicates costs. The 878-year lease with a peppercorn rent on offer effectively brings the full value of the flats into the leasehold interest and reduces the freehold value to close to zero.*

- 3. Q. Why is the offer for 878 years and not for 999 years?
A. *Rivermead Court Limited does not own the river frontage. It was leased in 1931 for 966 years and it is neater to make the new leases coterminous with this lease.*

- 4. Q. Do we all have to follow the same line?
A. *Rivermead Court Limited will have a single policy on the lease extension offer but it will be entirely the leaseholder's decision as whether he or she wishes to take up the offer. You are not obliged to extend now. It can be done at any time, but future changes in values, costs, years remaining on the lease, and "marriage value" (see question 6 below) should be taken into account. Any lease can run to full term if desired. In such cases, the property will revert to Rivermead Court Limited at the end of the 125-year term.*

- 5. Q. What if some leaseholders wish to extend under Rivermead Court Limited's proposals and others do not?
A. *For those not extending now, the cost of doing so in the future will rise by some 5% per year (excluding changes in property prices), and for those waiting beyond the point where there are fewer than 80 years left on their leases, the costs jump considerably due to "marriage value" (see the next question 6 below). In due course, the board expects all leases will be extended and this will provide a future source of income for the company. As stated in the explanatory paper, this income will be used to pay for future works and will help to minimise and potentially reduce the annual charges for all residents. Ultimately, as stated above, any lease not extended will revert to Rivermead Court Limited at the end of the original lease term.*

- 6. Q. What happens when the length of the lease falls below 80 years?
A. *Below is an example where the freehold of a property is worth £1million. A long lease on this property - say 200 years or more - would be worth virtually the same as the freehold. This is compared with the values where there is a short lease:*

Illustrative Example

Long lease – say 200 years		Short lease – say 50 years	
A. Value of 200 year lease	£1 million	A. Value of 50 year lease	£750,000
B. Value of Freehold reversion	near zero	B. Value of freehold reversion	£ 87,000
Total Value of property		Total Value of property	
Freehold + leasehold – A + B	£1 million	Freehold + leasehold – A + B	£837,000

The difference between these two totals creates a marriage value of £163,000. The freeholder would be entitled to 50% of this - £81,500. Normally the premium on the 50 year lease would be £85,000 and adding 50% of the "marriage value" of £81,500 increases the premium payable to £166,500. In the case of a lease of over 80 years the same situation arises. However the marriage value is much smaller, and all the increased value is enjoyed by the leaseholder. For this reason you should always look to extend a lease before it falls to 80 years.

7. Q. I am about to sell my flat and I don't want to wait until the extensions are offered. Will the purchaser be able to extend the lease under the same terms?

A. *Yes, as it is a voluntary offer, the new owner will have exactly the same rights as the original owner.*

8. Q. My neighbour had a lease extended for free. Why do we have to pay?

A. *In some cases of lease enfranchisement – usually relating to smaller blocks of flats – the leaseholders are legally co-owners of the freehold. In such cases, the freehold company will have acquired the freehold on trust (as nominee) for the tenants. The tenants can agree among themselves to extend their leases and there will be no tax consequences as the tenant would already be beneficially entitled to a share of the freehold in respect of his or her flat. As the lease extension is being granted by the tenant (as freeholder) to him or herself (as tenant), there would be no disposal for tax purposes.*

The original documents on the acquisition of the freehold of Rivermead Court have been exhaustively researched, and Counsel has been directly asked if there is any evidence of a declaration of trust in our case. Unfortunately, no declaration of trust can be discovered or implied. Rivermead Court is an independent company which owns the freehold in its own right. It is owned by the shareholders who also happen to be leaseholders and this arrangement means tax is payable on lease extensions.

If the tenants had extended their leases right away to the maximum extent possible at the time of acquisition of the leases, there would have been no gain. But this did not happen. The Freehold was acquired by the company and while most bought their leases at that time, some did not and only did so in later years.

9. Q. What actual tax is payable in the case of a nil premium?

A. There are two separate tax considerations.

First, where no premium is charged, tax Counsel's clear advice is that the notional value of the premium is treated as a distribution by the company and taxed as dividends in the hands of the leaseholder.

Second, according to the Chartered Institute of Taxation, when a company extends a lease it is giving up value, whether it receives payment or not. If the company receives payment – known as the premium – this amount less any allowable deductions is taxable at the 19% corporation tax rate. If the company does not receive payment, where there is a disposal other than at arm's length, the disposal will be treated as being for full consideration. Therefore, even if the Freehold Company grants the extensions for nominal value, it risks being treated for tax purposes as having received the lease premium that would have been charged using normal valuation principles.



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To put it another way, as Rivermead Court holds the freehold in its own right, it will be treated as acquiring the old lease and making a near complete disposal of its reversionary interest by granting a very long, extended lease. As part of the consideration for granting the extended lease the leaseholder surrenders the old lease. Section 17 TCGA 1992 deems that market value consideration will have been given for both the surrender and the regrant. In other words, the leaseholder has surrendered the 87-year lease for the notional full value and the company has regranted the longer lease for the notional full value. This point remains to be fully explored with tax Counsel.

10. Q. How is the tax calculated on (say) a £21,000 notional dividend?

A. *This depends on what other income you have. It will be treated as a dividend, added to the top slice of your income and taxed accordingly.*

11. Q. I have already paid for my HIU. If we follow the Board's recommendation will I get a refund?

A. *Yes.*

12. Q. Why will premiums increase by 5% every year?

A. *That is the rate established by precedent under the legislation.*

13. Q. What is the legislation that covers all this?

A. *It is the Leasehold Reform Housing and Urban Development Act 1993 as amended.*

14. Q. Who will pay the valuation costs and legal costs of extending the leases?

A. *The Company expects the premium income to be sufficient to enable it to pay for the valuation of all the properties and to pay its own legal costs. Paying leaseholder's legal costs may count as a distribution from the Company. We do not have Counsel's final opinion on this point.*

15. Q. Could we pay a ground rent and reduce the premium?

A. *The Board has considered this. A ground rent of £600 p.a. would probably reduce premiums by £10,000 but in effect it would be a loan in perpetuity at 6% p.a. which is not very attractive in the long run.*

16. Q. What about the remaining leased flats?

A. *Over the years, the few tenants who did not buy their flats under the original offer have gradually done so and the proceeds have been invaluable in providing funds for major works. There remain only two flats where original tenants did not take up the opportunity to buy the lease. One of these has recently become vacant on the death of the statutory tenant. The company also owns three flats for occupation by staff.*

17. Q. What is the next step?

A. *It is the Board's intention to have a consultation period after the AGM. We will obtain Counsel's final Opinion on the outstanding tax questions and issue further documentation where you can express your views. Thereafter, we hope to proceed without delay in valuing the flats and making an offer to residents.*

On behalf of the Board of Rivermead Court Limited

25 May 2018