Title:
Extension of Short Leases on Central London Properties

Word Count:
785

Summary:
Extending, purchasing and re-mortgaging short lease properties in Central London

Keywords:
Mortgages, Re-Mortgages, Finance, London

Article Body:

Facts

• The shorter the remaining term of the lease, the more difficult it will be to sell the property or for potential buyers to raise the finance

• Potential lenders usually require a minimum term of lease at outset of a mortgage facility and, also, require a 30+ years left on the lease at maturity of the mortgage term

• Properties in prime areas of Central London, typically, have leases attached to them with less than 30 years remaining (some have much shorter remaining terms)

• Since the Commonhold & Leasehold Reform Act 2002, it has been easier for an owner of a short leasehold property to extend the term of the existing lease, if he/she has owned the property for two or more years

• Few lenders have identified and responded to this niche lending opportunity; those that have done so, consider the location of the property and the status of the freeholder to be important factors in the mortgage application process

• Quality estate agents and valuers, experienced solicitors and enlightened independent mortgage advisers will all have significant roles to play in this business arena Financing the Extension of a Short Lease

A freeholder will require a monetary consideration in order to extend a lease and there are, essentially, three options for making that payment:

• Pay the premium to the freeholder out of one's own financial resources

• Apply to one's existing lender for a 'further advance' in addition to the existing mortgage

• Apply to another lender for a re-mortgage to pay off one's existing borrowing and raise the additional amount required to pay the freeholder

A lending institution will value the property on the bases of its current short lease and also the future increased lease term.

If approved, the mortgage will be based upon the revised lease term and, when the funds are released to the acting solicitor's client account, the new lease will be executed simultaneously.

Illustration:

An applicant has a 5yrs mortgage of £350,000 on a 15yrs leasehold property valued at £500,000 and he/she can acquire a 90yrs extension to the lease by paying the freeholder a premium of £250,000. The property's value will increase to £1,000,000 with the new 105yrs lease in place.

A £600,000 mortgage is approved and the £350,000 borrowing is redeemed and £250,000 is paid to the freeholder.

Purchasing a Short Leasehold Property

As, say, a 15yrs lease reduces so does the value of the property decline; a 'purchase' application, therefore, challenges a lender more than a 're-mortgage' application.

It is likely that, after two years of ownership, the purchaser will apply to increase the lease as in the preceding scenario; a lender cannot include that factor when considering a mortgage application for a purchase of a short leasehold property.

Again, using an existing 15yrs leasehold property and a 5yrs mortgage as an example, it is unlikely that a borrower would opt for a 'capital and interest' facility, given the likely repayments. An 'interest-only' mortgage product is not attractive to a lender because of the fact that the reducing lease is likely to have a declining value.

The answer can be a hybrid of the two loan types i.e. a mortgage that is part 'capital and interest' and part 'interest-only' in order that a lender's exposure re. loan/value is not impaired.

Illustration:

A lender is prepared to lend 70% of the purchase price/valuation and requires that the exposure is no more than 70% of the declining value at anytime throughout the mortgage term.

Purchase price/valuation of 15yrs leasehold = £500,000 Valuation of the property with 10yrs remaining = £350,000 Loan term is 5yrs

The lender is prepared to structure a loan on the basis that enough capital is repaid over the five years in order for the exposure to be no more than 70% of the declining value.

In this scenario, £350,000 would have been lent at outset (70% of £500,000 value) and after five years the borrowing would be reduced to £245,000 (70% of £350,000 value).

As the mortgage was for a five years term, the borrower would have to pay off the outstanding £245,000 at this time, having sold the property or from his/her own cash resources or having extended the lease and re-mortgaged.

Summary

The processes of purchasing, re-mortgaging or extending the leases of short leasehold properties require the services of knowledgeable and experienced advisers.

There is a slowly-increasing awareness of the market opportunity by a few of the more forward-thinking and flexible lending institutions.

A huge amount of prime Central London property is short leasehold, owned by highly reputable freeholders that have embraced the enfranchisement Act.

In future, those potential buyers of short leasehold properties or those wishing to extend their existing leases can do so knowing that professional and experienced support is available to them.