PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

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Ground Rent Consultation
3 SW, Fry Building
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DLUHC Consultation – Modern leasehold: restricting ground rent for existing leases

About the Pensions and Lifetime Savings Association

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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The PLSA appreciates the opportunity to respond to the Department for Levelling Up, Housing & Communities (DLUHC) consultation on modern leaseholds. We understand that the Government is consulting on options to introduce a cap on ground rents through primary legislation, which would apply to existing long residential leases signed before the Leasehold Reform (Ground Rent) Act[1] came into effect.

In recent decades, pension funds have participated in the residential ground rent market as institutional investors to meet their financial obligations, either lending to a residential property owned by a freeholder or by directly investing and becoming a freeholder themselves. A policy change that would cap ground rents would directly affect pension funds who bought assets on certain terms and in good faith, without due notice or compensation. Ultimately, this could negatively impact their ability to secure investment returns meant for the everyday savers they represent.

While we appreciate the Government's efforts to protect leaseholders, pension funds are equally concerned with protecting savers within their schemes. Any Government intervention should holistically consider the wider implications of placing a cap on ground rents so as not to create negative, unintended consequences, which could include (but are not limited to): a shortfall in pension scheme assets (which without compensation could directly impact scheme savers); UK investment market

[1] The Leasehold Reform (Ground Rent) Act 2022 freed future leaseholders from having to pay ground rent.

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reputational damage and decreased investor appetite in residential markets; and freeholder insolvencies that could ultimately harm leaseholders.

We therefore recommend that the Government explore further voluntary options with the industry, specifically pension fund investors, to create a plan and build on the action to date. This could include continuing the work done to address doubling ground rents, securing renewed commitments from freeholders, and addressing any other areas for reform.

Market Uncertainty

The Government has proposed five possible options for intervention: 1) Capping ground rents at a peppercorn (nominal financial value); 2) Capping ground rents at an absolute maximum value; 3) Capping ground rents at a percentage of property value; 4) Capping ground rents at the original amount it was set at when the lease was granted; and 5) Freezing ground rents at current levels.

Each of the proposed interventions would have varying effects on freeholders and institutional investors versus leaseholders, with the first option (capping ground rents at a peppercorn) having the most significant, detrimental impact on institutional investors by removing the leaseholder's financial obligation to pay a ground rent as of a given date.

Should the Government proceed with any of the proposed options, there is concern among members of the pensions industry that each would override existing contract terms. Setting this precedent – that the Government can make retrospective changes to preexisting contracts – will damage investor confidence in financial services and products in the UK more generally. This potential market uncertainty coincides with – and undermines – the Government's recent public calls for pension funds to provide additional capital to support growth in the UK economy, including through increased direct investment in infrastructure.

Beyond this wider market uncertainty, it is likely that capping ground rents will disincentivize future institutional investment in residential properties, especially a cap that would restrict ground rents at a peppercorn. For existing investors, capping ground rents could lead to insolvency, which would in turn create residual problems for leaseholders.

Compensation

Pension funds that are invested in residential ground rents do so to meet their index-linked liabilities. DLUHC's impact assessment estimates that capping ground rents at a peppercorn – the most extreme of the proposed options – would create a loss of £27.3bn (present value) in income for freeholders and institutional investors over the

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remainder of those existing lease terms. Within this, over a 10-year appraisal period in England and Wales, the expected loss is £5.1bn (present value).

Pension funds would suffer some portion of this loss, with the scale of any loss contingent on which of the proposed options is taken forward. Regardless of the policy intervention, the impact assessment suggests that pension funds would need to be the ones "to find alternate investments to meet those liabilities." However, any shortfall would be the direct result of the Government removing that asset value from a given pension fund's portfolio. It should follow that the Government – not the pension fund – be responsible for filling this gap with appropriate compensation.

It is important the Government remember that any losses incurred by pension fund investors are losses to the savers in those pension schemes. The consultation itself acknowledges that pension fund investors "bear leaseholders no ill will but are simply looking for the right income streams to meet their obligations." In this case, the financial obligation in question is providing savers in the scheme sufficient returns for retirement, and historically, ground rents have been a legal means to achieve this. Without compensation (or an alternative, equivalent investment solution), savers within pension scheme savers are at risk.

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We thank DLUHC for the opportunity to feed into this consultation on restricting ground rents, and we hope that our response is considered in any possible intervention to the ground rents market. We would be more than happy to respond to any queries or provide further information. Please contact Krista D'Alessandro, senior policy adviser, at krista.dalessandro@plsa.co.uk with any questions.

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