



**Law
Commission**
Reforming the law

Reinvigorating commonhold: the alternative to leasehold ownership

Law Commission Consultation Paper

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www.lawcom.gov.uk

The Law Commission is a statutory independent body created by the Law Commissions Act 1965 to keep the law of England and Wales under review and to recommend reform where it is needed.

The aim of the Commission is to ensure that the law is fair, modern, simple and cost-effective.

Why we are working on it

- Concerns about shortcomings of leasehold
- Increased by recent examples of abuse
 - eg escalating ground rents
 - eg use of leasehold for houses
- Commonhold offers an alternative

- Longstanding concerns about leasehold
- Recent instances of bad practice → renewed interest in leasehold reform
- 13th Programme of Law Reform:
 - Enfranchisement
 - Commonhold
 - Right to manage

- UK Government work
 - restricting sale of leasehold houses
 - reducing future ground rents to a nominal value
 - improving how leasehold properties are sold
 - charges paid by freehold houses for common services
 - regulating managing agents
- Other problems for leaseholders remain
- Welsh Government is also considering leasehold in general

Residential leasehold and commonhold: Terms of Reference

General policy objectives identified by Government:

- promote transparency and fairness
- provide a better deal for leaseholders as consumers

Specific policy objective identified by Government:

- To reinvigorate commonhold as a workable alternative to leasehold, for both existing and new homes

In order to do this:

- We are reviewing various legal issues within the current legislation which affect market confidence and workability, and making recommendations to enable commonhold to succeed

Commonhold and Leasehold Reform Act 2002

- Commonhold came into force in 2004, but fewer than 20 commonholds have been created
- Call for Evidence in February 2018
 - Mentioned issues of which we were aware
 - Asked if any others
- Survey of existing commonhold owners and managers
- Wide ranging review of current law of commonhold – why it hasn't worked, and what would be needed to make it work.

Consultation paper and Summary published 10 December 2018

<https://www.lawcom.gov.uk/project/commonhold/>

Online response form

<https://consult.justice.gov.uk/law-commission/commonhold/>

Our consultation closes on 10 March 2019

- The Government is looking at:
 - whether commonhold should be incentivised or compelled, and, if so, how; and
 - the non-legal issues which must be addressed to reinvigorate commonhold
- We have included consultation questions on these matters, but will not be making any recommendations on them



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Commonhold: what is it?

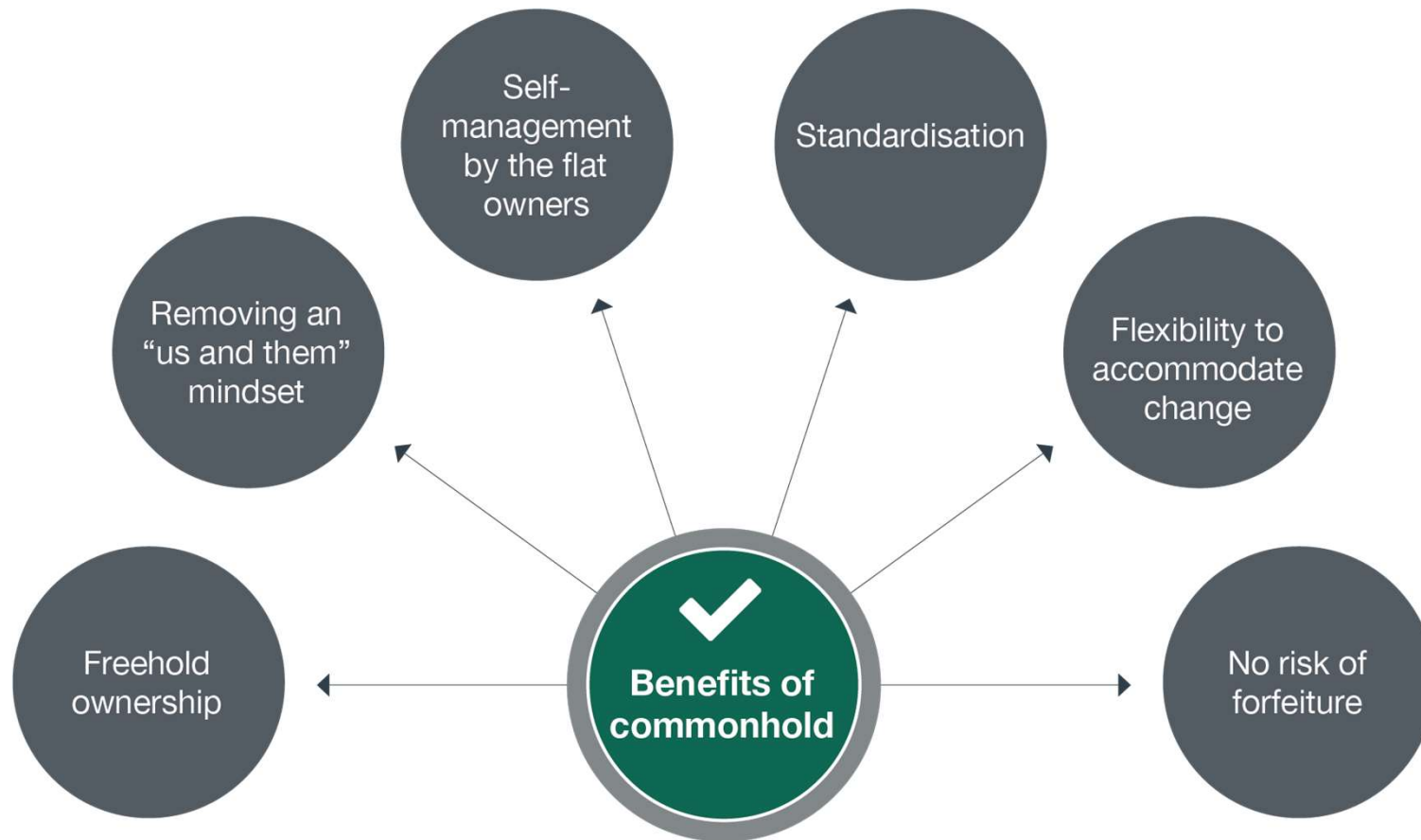
Freehold ownership of flats

... and other horizontally divided buildings

- Flats sold leasehold to ensure positive obligations can be passed to future owners
 - to keep in repair
 - to pay contributions
- Not a new tenure – each owner owns freehold of their unit
- Common parts owned by commonhold association
- All unit owners are members of the association
- Unit owners elect directors – manage or appoint agents
- Commonhold Community Statement sets out obligations



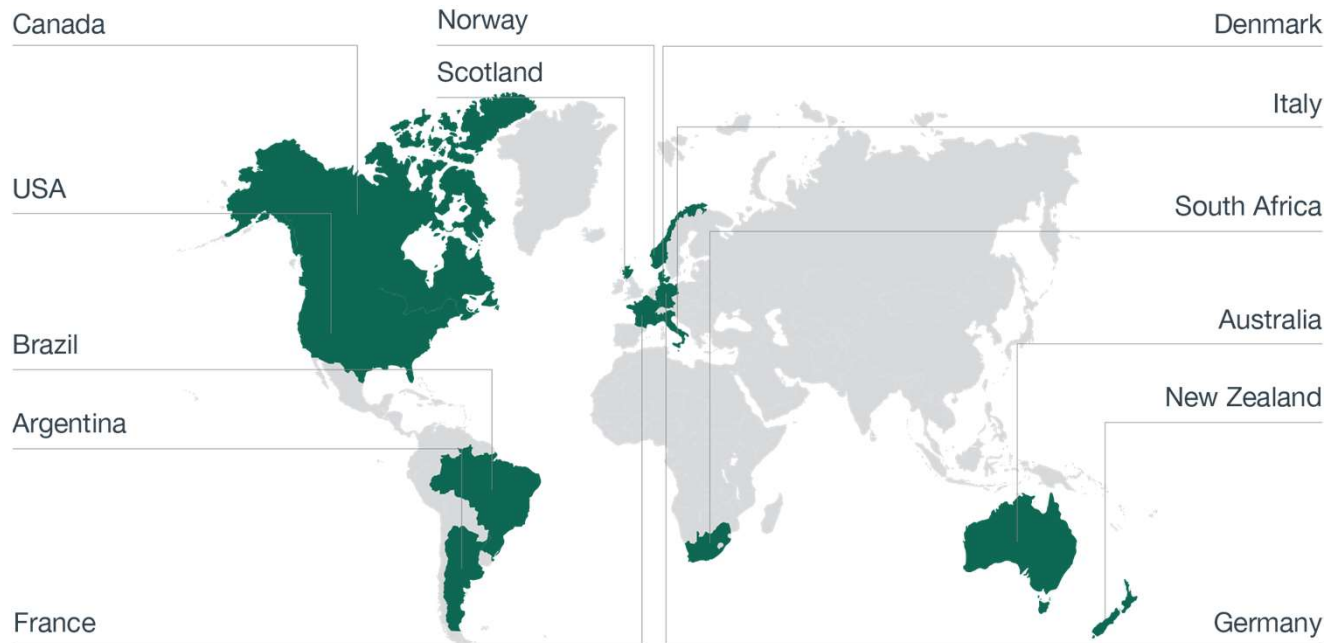
Advantages of Commonhold





Strata title, condominiums, unit-titles...

- Found throughout common law world and elsewhere
 - we have drawn on their experience





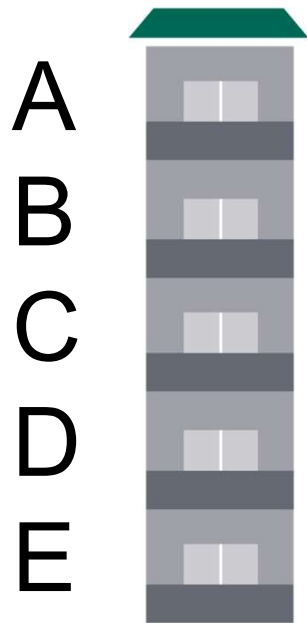
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Converting an existing building (or development) to commonhold

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- Under 2002 Act, conversion to commonhold requires consent of:
 - freeholder (so collective enfranchisement may be necessary)
 - all long leaseholders
 - all mortgagees of long leaseholders
 - In practice, impossible in large blocks
 - Should it be possible to convert without the consent of all leaseholders?

Converting to commonhold: an example

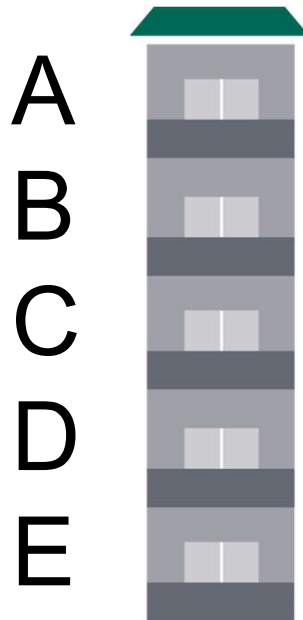
High Tower, containing five leasehold residential flats



Z - Landlord

- A, B, C, D and E each have:
 - 99-year lease
 - £100 per annum ground rent
- A, B, C, D and E all consent to conversion to commonhold
- Current law:
 - Conversion is possible
 - May need collective enfranchisement first (if Z does not consent)

Converting to commonhold: an example



If they converted to commonhold:

- Z would disappear
- leases would disappear – no longer a time-limited interest, and no ground rent
- A, B, C, D and E would each have a freehold interest in their flat
- decisions would be made by A, B, C, D and E by majority vote (or their elected directors)

Converting to commonhold: freeholder consent

What if landlord Z did not consent?

- A to E could get around Z's objection by using collective enfranchisement
- Normal qualifying criteria would apply – would only need 3 leaseholders
- We provisionally propose simplifying procedure
 - commonhold association can acquire the freehold

Converting to commonhold: leaseholder consent

What if leaseholder E did not consent?

- Collective enfranchisement still possible
- But as the law stands, there could be no conversion to commonhold
- We propose two alternative options:
- Likely only one will be recommended
 - Option 1: objectors retain leaseholds
 - Option 2: objectors have to take a commonhold unit



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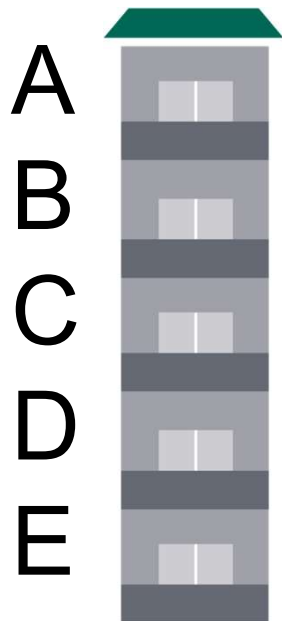
Converting to commonhold: leaseholder consent

Option 1:

- A leaseholder who objected would retain his or her leasehold interest after conversion

Converting to commonhold: leaseholder consent

Option 1: position after conversion



- A, B, C and D each have a commonhold unit and are members of the commonhold association:
- Commonhold association owns unit E
- E retains his/her 99 year lease of unit E and pays ground rent of £100 pa and service charges to the commonhold association
- Commonhold association owns the common parts – no landlord of building

Converting to commonhold: leaseholder consent

Option 1:

- This creates a position similar to that following collective enfranchisement where some leaseholders do not participate
- We therefore think the same level of support should be required to convert: **at least 50%**

Converting to commonhold: leaseholder consent

Option 1: temporary only?

- Having leases in commonhold could be made a purely temporary measure:
 - Unit owners could be given the right to acquire their freehold unit, not to extend their lease
 - Purchaser from owner who had retained lease could be required to take the commonhold unit



Converting to commonhold: leaseholder consent

Option 1: practical difficulties

- Terms of lease would apply as between leaseholder E and the commonhold association
- Statutory regulation of service charges would apply, e.g.:
 - s.20 LTA 1985 consultation
 - s.19 LTA 1985 reasonableness



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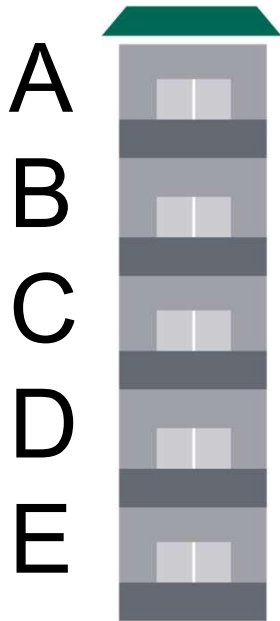
Converting to commonhold: leaseholder consent

Option 2:

- A leaseholder who objected would be required to take a commonhold unit on conversion

Converting to commonhold: leaseholder consent

Option 2: position after conversion



- A, B, C, D and E each have a commonhold unit
- Each is a member of the commonhold association
- Commonhold association owns and manages the common parts
- Commonhold operates as intended

Converting to commonhold: leaseholder consent

Option 2:

- This is more intrusive than Option 1
- We therefore provisionally propose that the level of support required to convert should be higher: **at least 80%**
- We also propose that without unanimous support, the approval of the Tribunal should be obtained



Converting to commonhold: leaseholder consent

Advantages of Option 2:

- Management is simpler – the Commonhold Community Statement applies to everyone

Disadvantages of Option 2:

- More significant interference with property rights
- Leaseholder could prefer to retain rights under lease and statutory protections
- Problem of financing freehold purchase

Converting to commonhold: Some questions

1. Do you prefer Option 1 or Option 2?
2. Or should we retain the requirement for unanimous consent?
3. Are there any other options we should consider?
4. Do you agree with 50% threshold for Option 1?
5. Do you agree with 80% (plus Tribunal approval) for Option 2



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Mixed-use developments



Developments are becoming more complex...

CAM 1 – Y CYNIGION DYLUNIO MANWL PHASE 1 – THE DETAILED DESIGN PROPOSALS



Y GWESTY (I FOD YN GAIS AR WAHAN; THE HOTEL (TO BE A SEPARATE APPLICATION))



GOYGFA O'R GORLEWIN - VIEW FROM THE WEST



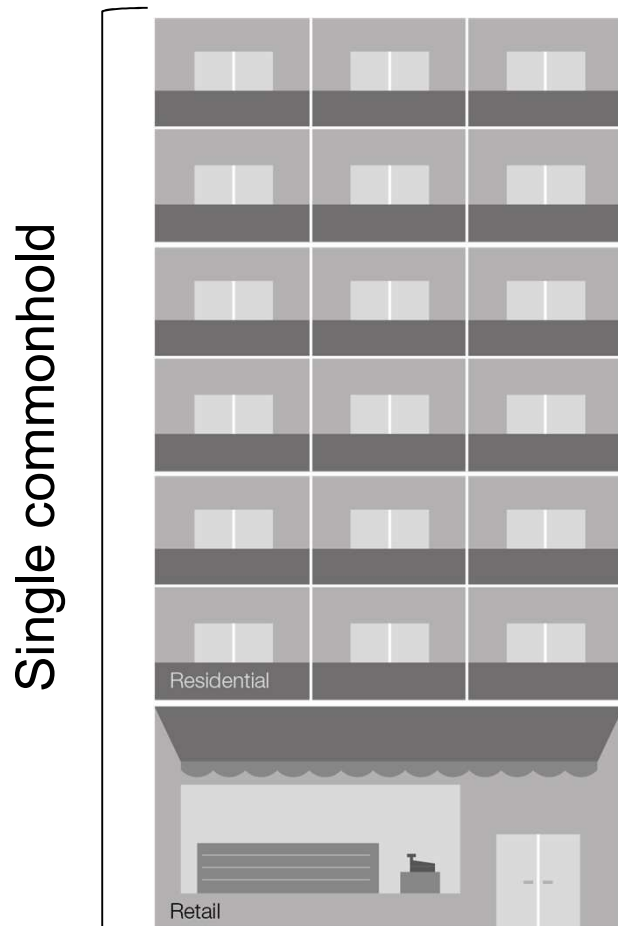
Y BONL YNCHYD A MAES PARCIO, ADELAD PRESWYL, MANWERTHU A BWTYAI - THE BRIDGE, PLUS CAR PARK, RESIDENTIAL, RETAIL & RESTAURANTS BUILDING





Mixed-use block

Under current law would have to be a single commonhold



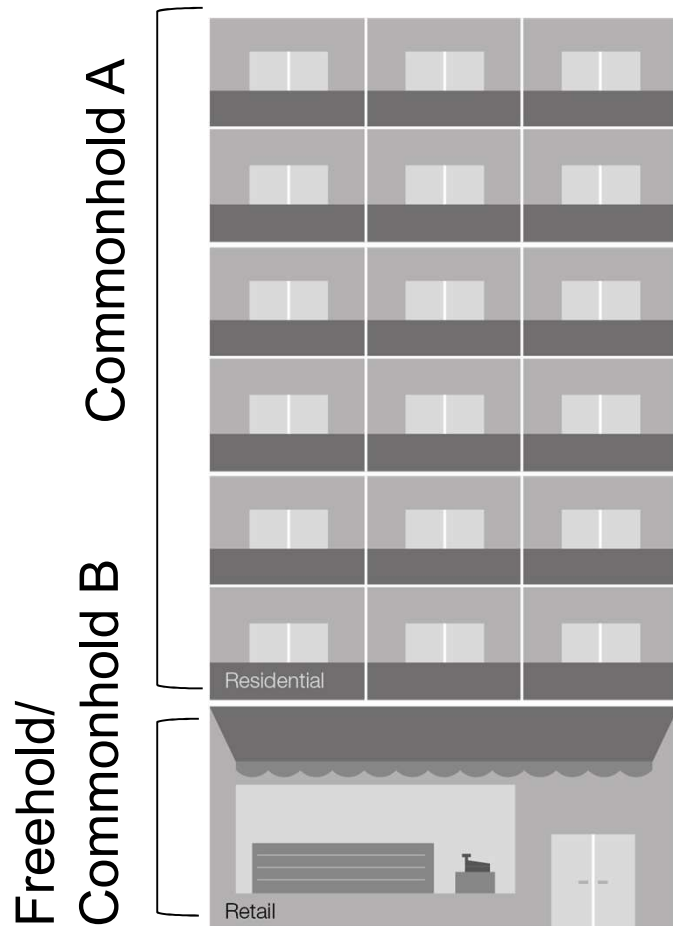
Residential flats on upper storeys

Ground floor retail units



Mixed-use block: flying commonholds?

“Flying commonhold” adopted



Residential flats on upper storeys
make up one commonhold

Ground floor retail units are either
retained by freeholder OR make up
another commonhold of retail units



Mixed-use block: layered commonholds?

“Layered commonhold” adopted



Residential flats on upper storeys make up one sub-commonhold

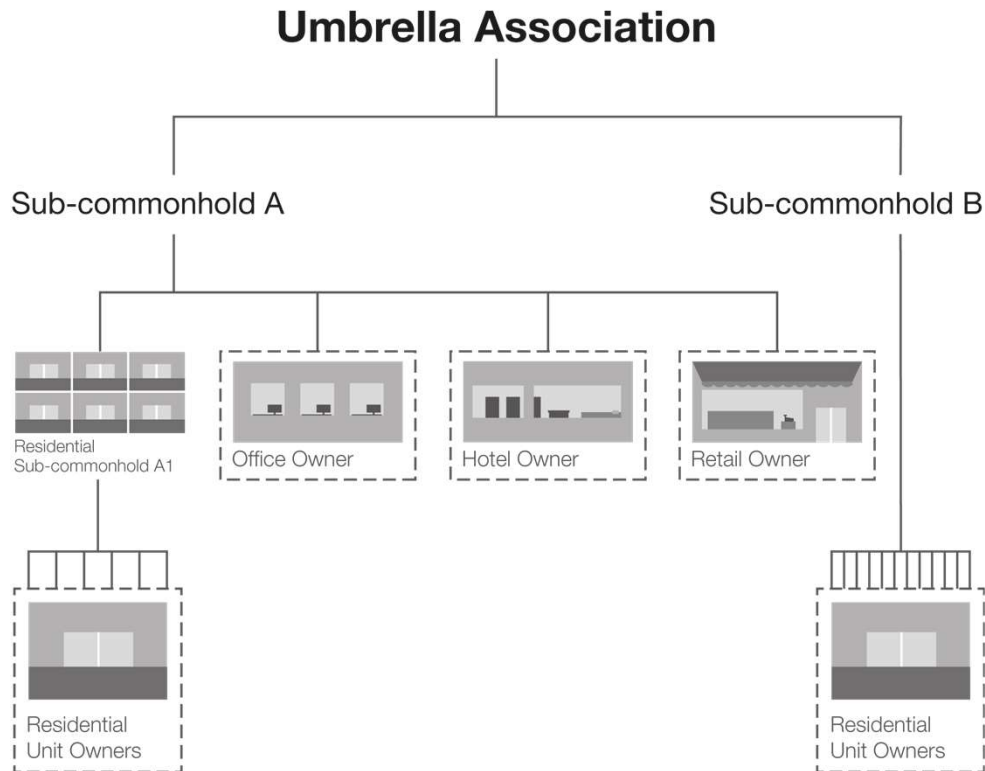
Ground floor retail units make up another sub-commonhold

“umbrella” commonhold comprising the two sub-commonholds



Mixed-use blocks: layered commonholds

But layered commonholds can get very complicated....



Each sub-commonhold would be a separate corporate body, with its own board of directors

(FOUR separate boards of directors here)

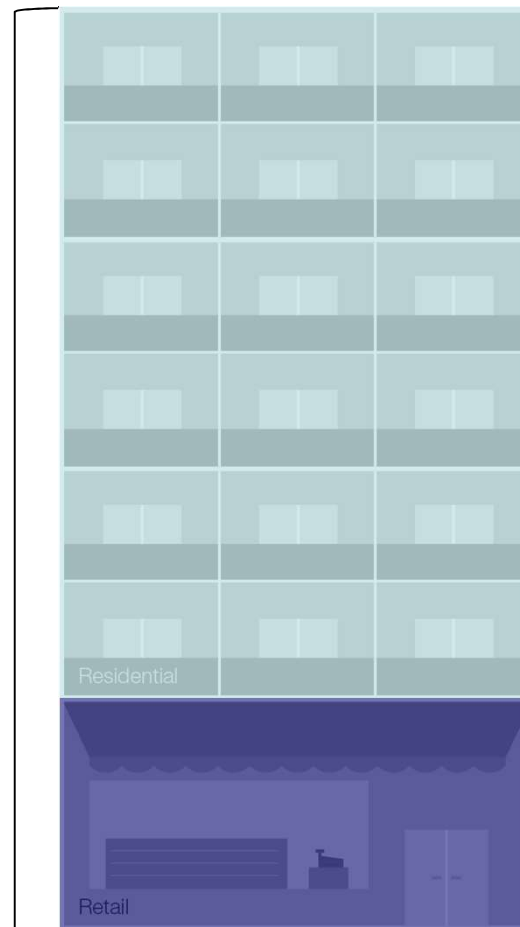


Mixed-use block: Sections

“Sections” adopted

Single
commonhold, but

- owners can vote by section
- each section can have a sub-committee



Residential flats on upper storeys
make up Section A: Residential

Ground floor retail units make
up Section B: Commercial



How sections might work in a larger development:





Accommodating mixed uses: some questions

-
1. Does commonhold need to accommodate mixed-use developments?
 2. Would “flying commonholds” sufficiently address the difficulties?
 3. Would “layered commonholds” with multiple legal entities work in practice?
 4. Would our proposal for “sections” be preferable?
 5. Are there any other, better, solutions?



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Issues on financing the commonhold

Issues that have arisen

- What happens if the commonhold association becomes insolvent?
- How can we prevent the association from becoming insolvent in the first place?
- How can we mitigate the position if the commonhold does become insolvent?

What happens if the association becomes insolvent?

- Lenders have expressed concerns over this
- We do not think there is a problem over their security
 - a legal charge will remain registered against a unit
- But the block will have become a group of “flying freeholds”
 - lenders say that they would never have lent on a flying freehold!
- Our priority is to prevent insolvency in the first place

Preventing insolvency in the first place...

- Requiring commonhold associations to take out public liability insurance
 - Experience in other jurisdictions of “catastrophic” claims
 - We are consulting on practicalities
- Requiring commonhold associations to set up reserve funds
 - Clarifying protection gives an incentive to use them
- Giving the commonhold association a first charge over unpaid commonhold contributions

An automatic first charge?

- Some have suggested a first charge is essential
- Lenders are worried about what happens if a commonhold association becomes insolvent
- From lender's point of view, it broadly replicates what currently happens with forfeiture of leases

The current position under leasehold forfeiture

- If service charges are in arrears, landlord will generally write to the owner's mortgage lender
- Lender will generally clear debt (may require a Tribunal ruling to ensure borrower cannot challenge the charges)
- Lender will then add the sum paid to the mortgage debt
- Lender will generally do so even if "negative equity"
 - forfeiture would result in loss of their entire security

Advantages of automatic first charge to the unit owner

- This is not forfeiture – the unit owner gets back the full value of the flat, after deducting:
 - mortgage debt
 - arrears of contributions
 - (so no “windfall” to the commonhold association)
- Protections similar to s 36 of the Administration of Justice Act 1970 can be built into the system
- We recognise that an order for sale would be hard on unit owners
 - alternative is that their neighbours have to subsidise them

Advantages of automatic first charge for lender

- First mortgage lender (and so on down the line) will get what is owed to them
 - no need to apply for relief
 - and no complication of belated applications
- Helps address lender's concerns over commonhold associations becoming insolvent
 - (so they are left with “flying freehold” securities)

Ensuring insolvency is an absolute last resort

- As a limited company, a commonhold association could enter into a Company Voluntary Arrangement
 - are modifications needed for commonholds?
- Requiring creditors to petition for appointment of “commonhold administrator” as a first step
 - only if the association was “irretrievably insolvent” would the administrator request the court for a winding-up

The successor association – the dilemma

- The commonhold needs a commonhold association in order for the commonhold to function properly
- As the commonhold association is a limited company, it has to be possible for it to be wound up
- The CLRA 2002 provided for a “successor association”
 - Insolvency Court could give permission for a new association
- Appears that conditions could be imposed – but unclear how strictly this should be applied
- Might undermine concept of limited liability altogether

The successor association – our provisional proposals

- The court should usually appoint a successor association
- The court should have a discretion as to imposing conditions
- The liquidator should not be able to demand further new contributions from the unit owners, except when the court required it

We are consulting on:

- Whether the court should **ever** not appoint a successor association
- If so, when?
 - a structured discretion?

Preventing insolvency: some questions

1. Should the commonhold association have an automatic first charge for arrears of commonhold contributions?
2. Should associations be required to take out public liability insurance? To have reserve funds?
3. Does the Company Voluntary Arrangement procedure need modifications?
4. Would the Commonhold Administrator idea work?
5. Should there be circumstances when a successor association should NOT be appointed? When?