Further Leasehold Reform
Radical thinking?

A paper for an all-party meeting on 29th January 2015 organised by LKP/CARLEX.

By Philip Rainey QC

Introduction

1. I have been invited to float "radical suggestions" for leasehold reform (other than commonhold which is a separate matter).

2. I have no political standpoint on any of this. I hope that all shades of opinion would agree that *better* regulation is the objective and is not necessarily synonymous with *more* regulation.

3. I have taken as a starting point the propositions (1) that the principal reason why flats are leasehold is the unenforceability of positive covenants in freehold land, and (2) that the principal problems to be addressed are (a) "the wasting asset" problem and (b) management control (including control over the levying of service charges by those who have to pay them). For these propositions see *Majorstake v Curtis* [2008] 1 AC 787 at §§20-23.

4. I have also borne in mind that complex law provides a fertile ground for lawyers and is often less effective than a simpler but less comprehensive solution because ordinary lay people can't get to grips with overly-complex provisions.

5. It should not be assumed that I agree with all or indeed any of the ideas set out below. The intention is to stimulate debate. I would be surprised if any informed reader of this paper agreed with all of it but I would be disappointed if all readers disagreed with the same parts of it. I hope that this paper will be reviewed in that spirit.

6. I could also provide a much longer list of detailed reforms of existing legislation which would have a significant cumulative impact "at the coal face" but which would make for

spectacularly dull reading. I have appended a few bullet points along these lines at the end of this paper.

Radical suggestions

7. **Legislate so that positive covenants can run in respect of freehold land; or at least in respect of residential flats**

   Observations: This would cut away the reason why long leasehold flats exist in the first place. However, such a reform might still be ignored by developers, who might still prefer to create a leasehold structure for new flats. Management control would remain an issue with larger blocks (hence the idea to create commonhold) but with smaller properties comprising two, three or four flats (of which there are many) a "freehold flats" regime could work well. Devices such as the "Tyneside Lease" would be unnecessary.

   Devil in the Detail: Not necessarily that much: why not implement the recommendations in *Report on the Law of Positive and Negative Covenants* (1984) (Law Com No 127)?

8. **Prohibit the grant of new long leases of houses**

   Observations: It is not easy to see why new leasehold houses should be built, except perhaps to preserve estate management which is an issue which can be dealt with by other means.

   Devil in the detail There will be cases where the occupier would not be considered as entitled to a freehold and for which exceptions could be made e.g. the Crown Estate, properties in National Parks etc.). Query shared ownership; although one might ask – why would a trust model not work for houses? As to the issue of maintaining the appearance of estates, and paying for the maintenance and upkeep of common areas, suitable new developments could be the subject of an **Estate Management Scheme** modelled on the jurisdiction under Ch.IV of Part 1 of the LRHUDA 1993 but with power to vest the management in a representative body of tenants / householders.

   Or – to take that thought a stage further - why not set up larger, self-contained developments of houses and flats as a Parish and vest the external common areas, footpaths etc etc. in a Parish Council?

9. **Prohibit the grant of leases of flats for a term of between 21 and 999 years**

   Observations: i.e. legislate that leases must be either short or very long. For the future, this eliminates the "wasting asset" problem. Many new leases are 999 years in any event.

Given that all long leasehold flats (with very few exceptions – eg flats held on business leases) can be the subject of new lease claims under Ch.II of the LRHUDA 1993, and that such claims can be made any number of times, it is very difficult to see why new long leases should not be very long, such that there is no valuable reversion. Coupled with a prohibition on ground rents, there would be no value in the landlord's reversion, and the norm would be that it is handed over to the lessees. If not, it would cost the lessees nothing to enfranchise.

Devil in the detail: The inclusion of break clauses would also need to be prohibited. But one conceptual difficulty with such long leases is that it seems unlikely that the flat will exist in 1000 years' time. Break clauses on grounds of redevelopment, with compensation at (say) 90 year intervals (I model this on s.61 and Sch.14 of the LRUDA 1993) could be permitted; indeed could be *mandatory* to ensure that redevelopment of cities is not strangled. There would also need to be an exception where there is an existing head-lease, out of which such a long term cannot be granted. Indeed the position of head-leases of blocks of flats generally would have to be carefully considered.

OR

10. **Abolish the rule of common law which prevents the grant of indeterminate leases and legislate for new "long leases" of flats to be indeterminate**

    Observations: The utility of this rule was queried by the Supreme Court in *Mexfield Housing Co-op v Berisford* [2012] 1 AC 955 (esp at §§33-34). Instead of providing for very long leases, legislation could both permit and require the grant of indeterminate leases of flats at no rent, capable of termination only on strictly limited grounds; most obviously redevelopment (with compensation for value as under Sch.14 of the 1993 Act); possibly also for serious and repeated breach of covenant (but as to this, see below).

    Devil in the detail: consistent with an intention to eliminate reversions, there is another disreputable common law rule which could usefully be abolished, namely **abolish the rule which holds that the grant of a sub-lease for the residue of the term of a head-lease operates as an assignment of the head-lease**.

11. **Convert all existing leases with unexpired terms in excess of (say) 125 years into 999 year terms or indeterminate leases with a redevelopment break clause**.

    Observations: Again, to eliminate the wasting asset issue.

Devil in the detail: This would be a deprivation of an asset for the purposes of A1P1 of the ECHR. Compensation would be an issue if value were involved. I picked 125 years because at that lease length the reversion would usually be of negligible value but on very valuable flats this may not be so.

12. **Prohibit the reservation of ground rents on new long leases of flats**.

Observations: seems inconsistent in principle with modern concept of owning one's own home and that a flat held on a long lease belongs to the lessee. New leases acquired under the 1993 Act are always at a peppercorn rent (s.56(1)). There is a market in portfolios of ground rents: why should this investment opportunity exist? It could be argued that banning ground rents would increase the price charged by developers to buyers and thus fuel house-price inflation because they sell on the reversion. That seems logical, provided of course that one assumes that the flats are generally discounted and not sold for the most that the developer can get.

Devil in the detail: Attempts would no doubt be made to disguise rent as something else. Prohibition would have to be widely drafted e.g. prohibit "non-variable" "service charges", prohibit clauses which "indemnify" against a head-rent and so forth). On the other hand, one might wish to except certain types of flat e.g. student accommodation, some social housing, the building of which may be financed in part by reserving a significant income stream on a mid-length lease, which income can be used as a security, or securitised.

13. **Repeal the right to a new lease of houses under the LRA 1967**

Observations: To be consistent with a general prohibition on long leasehold houses and the abolition of ground rents. Also this right is limited to low value houses, is little used nowadays, the form of lease includes a high ground rent and is otherwise unsatisfactory. An example of something the statute book could do without.

14. **Amend the LRHUDA 1993 so as to provide for the acquisition of a 999 year lease, or indeterminate leases, and to eliminate head-rents**

Observations: Such amendment would be needed for consistency with the other proposals I make. Since repeated new lease claims can be made, acquiring an additional 90 years each time, there seems no sense in limiting the new term to 90 years. Requiring that new leases be 999 years would simplify claims because the freeholder would always

be the competent landlord. Commuting head-rents would be consistent with the overall "no ground rent" objective and would eliminate the problem that at present the exercise of rights by the qualifying tenants creates a negative income stream for the head-lessee which in turns leads to difficult valuation issues. In some cases the price goes up, in others the freeholder loses out (see *Nailrile v Cadogan* [2009] 2 EGLR 151 and *Cooper-Dean Trustees v Greensleeves*)

Devil in the detail: If new leases under the Act are 999 years or indeterminate, it would make sense for the grant to be subject to a redevelopment break clause as per the existing section 61 and Sch.14 on every 90th anniversary of the original term. It may make sense to give head-lessees the right to buy down their head-rents.

15. **Abolish the forfeiture of residential long leases**

Observations: The notion that a valuable long lease can be extinguished and the value taken by the landlord is anathema to modern concepts of ownership. But the response so far, which is to apply extensive restrictions, can leave landlords (such as tenant management companies) without a clear way to deal with bad tenants. I suggest replacing forfeiture of residential long leases with a procedure whereby a landlord can apply to the court for an order for sale in cases of (serious) breach; akin to a mortgagee's action – so the tenant or tenant's mortgagee receives the proceeds less any provable damages / costs.

Devil in the detail: The above proposal is actually not radical at all: it is a truncated, "lite" version of a comprehensive proposal to abolish and replace forfeiture in respect of all leases as proposed by the Law Commission in *Termination of Tenancies for Tenant Default* (Law Comm 303 (2006)). Why not simply implement that Report and sort out the law more generally? If the reason is resistance borne of deep worry within the commercial sector, where termination of relatively short (eg 5 year) tenancies is a much more frequent occurrence, I would suggest implementing the Law Commission proposal in the long-leasehold residential sector first and extend it to commercial leases once it is seen to work.

16. **Enhance existing enfranchisement rights**

Observations: The 1993 Act procedure (unlike the 1967 Act) is riddled with "trap" notice requirements and time limits with no power of extension and where non-compliance has catastrophic consequences for landlord or tenant(s). It is nearly 22 years since the Act

became law but these provisions cause as much trouble as ever. Experience shows this trouble is far more than these requirements are worth; claims collapse and in some cases are not renewed as the tenants are "burned" by the experience. I suggest a single, simple procedure for all types of claim and with most if not all court jurisdiction transferred to tribunals.

Devil in the Detail: If there were to be an overhaul of enfranchisement, there are some quite problematic issues which could usefully be addressed. E.g. amend the LRHUDA 1993 so that tenants who have acquired an intermediate superior interest to their flat cannot have that interest compulsorily acquired on a collective claim. Amend the "no Act" assumption in 1967 and 1993 Acts so that the assumption is that no such leases have Act rights. (At present the no-Act assumption applies only to the building, and an argument is emerging that with universal enfranchisement rights the assumption means that leases are valued at a *lower* value than they would have had if there had never been an Act when what was intended was simply that the existence of the Act should not *increase* the value of the tenant's lease/decrease the value of the reversion).

17. **Prevent rights of enfranchisement being exploited by business.**

Observations: "Marginal" enfranchisement claims breed dissatisfaction with the process. Such claims also by their nature tend to be resisted and occupy court time. It was not intended by Parliament that repeal of any residence requirement would enable businesses to enfranchise but the business lease exception in the 1967 and 1993 Acts is badly drafted and ineffective. Re-draft it so that it actually works – provide that the business at the relevant premises need not be carried on by the qualifying tenant.

18. **Repeal Part I of the Landlord and Tenant Act 1987** (right of first refusal)

Observations: This right was the product of the Nugee Report in 1985, which concluded that although there was strong support for enfranchisement of flats, a right of first refusal coupled with the right to appoint a Manager if landlords were in default of their obligations would suffice. Now that we have collective enfranchisement, lease extension rights for all flats and no-fault Right to Manage, the right of first refusal is in principle redundant. In practice, it is worse than redundant, because it is one of the most ill-drafted pieces of legislation ever inflicted on us. To the extent that it applies to properties or tenants who do not have enfranchisement rights, one must query "why should it?" It is easily avoided by those who have the money to pay for expert advice;

but generates disputes as to the efficacy of the avoidance. Its existence is a disincentive to mixed use schemes and tends to act as a drag on the ordinary commerce of trading mixed use investment.

Devil in the detail: Very little. It can simply be repealed. **Part III** (acquisition orders where a landlord is in default) could be merged into the enfranchisement procedures by way of further simplification and rationalisation.

19. **Abolish the vesting of freehold or leasehold reversions in the Crown where a landlord company is struck off the Register of Companies or is dissolved.**

Observations: At present, reversions vest along with all other property: bona vacantia. There may be a disclaimer on insolvency followed by an escheat to the Crown. Many investment vehicles are offshore; on dissolution of offshore companies there is escheat. It is highly unsatisfactory that long lessees of flats can get dragged into this:-

…This case raises a difficult but important point as to the application of the Landlord and Tenant Act 1987 to premises the freehold of which has been disclaimed on the insolvency of the landlord. If the argument of the defendant is well-founded, there is a significant lacuna in the provisions of the Act, resulting from the operation of the medieval doctrine of escheat. I have to say that I was initially amused, but ultimately dismayed, that the rights of the parties under a modern statute reforming the law of landlord and tenant should depend on the vestiges of feudal land law. My dismay grew as it became apparent that my decision in this case involved an examination of fundamental concepts of our land law, and an examination of concepts and authorities dating back several centuries. It was with some relief that I noted that the last authority to be cited in this case was a textbook dating from as recent a date as 1794; but even that referred me back to medieval writs of escheat… (*SCMLLA v Gesso*, 1995)

Tenants can be left having to apply for vesting orders with unsaleable leases in the meantime (and they are Crown tenants, sometimes losing the protection of statutes inapplicable to the Crown). The Crown can (and sometimes does) sell the reversion to anyone it likes. I suggest that reversions on flats should vest by law in a statutory body, with a simple procedure for vesting *at no cost* in a company similar to a RTM company set up by the tenants.

Devil in the detail: provision would have to be made for the potential for the company to be restored to the register (with a cut-off date) which would ordinarily re-vest property in the company.

20. **Extend RTM to the interest of residential head-tenants even where the block is unenfranchiseable. Or extend RTM to the residential parts of buildings currently disqualified.**

Observations: Right to Manage presently only applies to premises which would also qualify for collective enfranchisement. But the exercise of RTM only applies to the residential parts of those premises; so it is not altogether easy to see why RTM cannot be extended to cover the residential parts of all or most mixed-use blocks, many of which are presently managed through a residential head-lease. The equation of RTM with enfranchisement was in part driven by the failed attempt to introduce "Right to Enfranchise" (RTE) companies which were supposed to dovetail with RTM companies. The consultation at the time of the 2002 Act also indicated that once RTM had bedded in Parliament would look at extending it.

21. **Overhaul, clarify and simplify the procedure for the acquisition of RTM. No longer require 50% participation**

Observations: There is currently a cottage industry in resisting RTM because acquisition of the right is beset by technicality and because, if the landlord wins, he gets his costs, but if the tenants win, they don't. Acquisition procedures should be simplified and the effective one-way cost-shifting repealed. More fundamentally, it might be queried why 50% of tenants should have to back RTM (by joining the RTM company) given that once it is acquired, the numbers who are members of the company may drop below 50% without any particular consequence. Perhaps 35% should be the cut-off?

Devil in the detail: If RTM were to be overhauled, there are many detail reforms which ought to be made. RTM is, in practice, not as satisfactory as it seems: the ambit of the RTM company's rights are actually quite unclear. It would be useful to extend the FTT's jurisdiction over disputes with, and within, RTM companies.

22. **Relax the regulatory regime controlling service charges for tenant-owned landlord /management companies**

Observations: The panoply of controls on management, service charges and administration charges are designed for an arms' length relationship between landlord and tenants. It is far from obvious why such close regulation should apply where L and T are the same people wearing different hats. If the tenants in a small block meet around

the kitchen table and decide to XYZ, why should they have to serve a s.20 LTA 1985 consultation notice? Service charge disputes are a zero-sum game.

Devil in the detail: Those observations are applicable only if the landlord (or management company or RTM company) is representative of the tenants. Enfranchisement can be achieved by a bare 50% of long lessees; that would result in what would be more accurately described as a "neighbour owned" block rather than "tenant owned". There could be a threshold for relaxation: a landlord *wholly* owned by *all* the long lessees in a block (or by an overwhelming majority e.g. all lessees bar one/90% of lessees in blocks with more than 10 flats)

23. Permit local authority landlords to levy major works service charges separately from the "day to day" costs

Observations: This suggestion builds on the 2002 reforms which introduced Qualifying Long Term Agreements, which enable local authorities to enter into Partnering Agreements with contractors. The problem is that major works often straddle many blocks in more than one accounting year; tenants are eligible for loan assistance or a monthly payment plan for such works but not day-to-day charges, councils find it hard to estimate the cost of major works for a tenant for a particular year, tenants often like the transparency of separate estimates and bills for the major works. Yet the Right to Buy leases always require annual accounting and a minority of tenants are challenging the separate bills for major works, causing a huge amount of work (and some loss) for the Councils in producing lease compliant billing. Such losses are met from the Housing Revenue Account, i.e. the secure tenants subsidise those who exercised RTB (many of whom have now sold on to buy-to-let investors). I suggest that a term be implied into all RTB leases legitimising the common billing practice for major works.

Devil in the Detail: **reform of s.20B of the LLTA 1985** ought to be included; this section is intended to protect tenants from late service charge claims by imposing an 18 month time limit on recovery of costs unless the tenant was notified of the figure. But as part of the cottage industry in challenging local authority service charge billing it is used by tenants as a defence where the local authority re-bills on an annualised basis.

24. Extend the rights to vary leases under Part IV LTA 1987

Observations: There are several holes in this very useful jurisdiction e.g. it should be possible to re-distribute service charges among tenants where in aggregate they add up to

100% but they are skewed, sometimes to favour flats held by entities associated with the landlord; e.g. it should be possible to substitute a new tenant management company where the original company has been dissolved. E.g. it should be possible to vary a clause which renders the lease unsuitable as security for lending

25. **Regulate managing agency**.

Observations: hardly a radical suggestion; probably one for political judgment. Drafting would be easy – just copy the Housing (Wales) Act 2014.

26. **Prohibit cross-ownership or control of managing agents**.

Observations: It is currently lawful for a landlord to have a managing agency arm, or subsidiary, and to use that arm to manage its own portfolio while recovering management fees under the leases. Lessees often complain that such agents favour their parent landlord. This complaint would be eliminated if cross-ownership were prohibited, or if such "in house" agents could not recover management fees under leases.

Devil in the detail: One would have to specify carefully what forms of cross-ownership were prohibited; attempts at getting around the restrictions should be anticipated. But models controlling cross-ownership exist in other fields e.g. the media.

27. **Prohibit managing agents from carrying out claims management or insurance broking services; require consultation under s.20 LTA 1985 on insurance**

Observations: Retention of insurance commissions or discounts by landlords or their agents is a major concern. One recognised justification for retention of such payments is where they are, on paper at least, consideration for claims management services or where the agent is also registered as an insurance broker. Requiring that third party brokers or claims managers must be employed would cut off this justification. Imposing a consultation requirement similar to that which applies to qualifying works and QLTAs would include requirements for disclosure of the premium, commission payments and discount structures, increasing transparency.

Devil in the detail: Again one would have to specify carefully what forms of cross-ownership were prohibited; attempts at getting around the restrictions should be anticipated. Landlords might simply set up an insurance broking business. Query what the consequences would be of inadequate consultation following *Daejan v Benson*.

28. **Substitute a civil penalty regime for the various criminal penalties for non-compliance with statutory provisions**

    Observations: The principle of criminalising things like failure to provide a statement of account on time must be questionable. Whether the criminal courts are the most effective vehicle for enforcement by local housing authorities is equally questionable.

    Devil in the detail: Not much: see the Consumer Rights Bill Schedule 9 for a model.

29. **Limit the effect of rent and covenant-compliance conditions on break clauses**

    Observations: more of an issue in commercial leases than residential, but something of a scandal nonetheless (in my view). The "trap" into which the uninitiated fall is that they see a break clause, and they see that it requires payment of rent up to the break date and that covenants must be complied with. But they don't realise that requirements of the content of a notice must be strictly complied with so that any error or omission is fatal, that paying rent due up to the break date may involve making a payment in advance for a period beyond the break date, and they don't realise that even if a trivial breach of covenant can be proven (e.g. they failed to repair a cracked tile in the WC) the exercise of the break is invalid. None of this is business common sense.

    Devil in the Detail: Suggest legislating (1) to override lease clauses requiring break notices to be in a precise form, so that unmeritorious process points could not succeed where it could be shown (a) that the notice, however served, reached its target; and (b) that the purport of the notice was reasonably obvious – no matter what additional complexity the lease might require (2) to allow for apportionment on the payment of rent and other monies up to the break date (3) restitution of overpayments for rent etc. beyond the break date and (4) implying a term into all such break conditions that a clause which requires that a tenant must have complied with covenants in order to break the lease requires substantial compliance only (abrogate "complete covenant compliance" or "CCC" clauses).

Exit fees

30. I have steered clear of the issue of "**exit fees**" and related charges, found often in leases of retirement homes, because the Law Commission has now begun a project concerning this issue. However, any final recommendations are unlikely to emerge until March 2017 and any legislation based on those recommendations would not take effect until a somewhat later date. But in 2013 the OFT noted that a number of forms of exit fee clause are likely to be unlawful under existing consumer protection laws such as the

Unfair Terms in Consumer Contracts Regulations 1999 (which will be replaced by the Consumer Rights Bill currently before Parliament). Problems with the status quo are (among others) that they are often paid albeit under protest in order to allow a transaction to proceed and that the only forum for challenge is to sue in court. **A modest, non-radical suggestion for immediate reform**, and which would not pre-empt the Law Commission – would be (a) to confer on the FTT a new *jurisdiction* to consider challenges to exit fees brought under *existing substantive law* and (b) (subject to a short Limitation Period) to permit challenge to and recovery of exit fees after payment if they are found not have been due.

PHILIP RAINEY QC
Tanfield Chambers,
London WC1

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Possible technical improvements to the legislative regime – a selection

1) Consolidate the disparate landlord and tenant legislation into a single Act or series of Acts with a logical structure.
2) Repeal the unworkable versions of various sections never brought into force and which litter the statute book.
3) Replace the current statutory provisions for service charge accounting with new versions based on an "implied term" model thus building on what most leases say rather than trying to have parallel regimes. The latest versions are unworkable and not in force. If the provisions impose work on landlords, the costs will be often fall to be met by the tenants as costs of management, so the benefit needs to be clear.
4) Ditto the provisions for holding service charge accounts on trust.
5) Overhaul the Service Charge Consultation Regulations, the Schedules to which are very obviously comprised of parts drafted by different people and consequently have inexplicable inconsistencies
6) Clarify the position of clauses allowing for recovery of legal costs: are they are a service charge, or an administration charge, or both? Or neither?
7) Permit long lessees of dwellings to enforce certain covenants such as covenants against nuisance, against their neighbours, even if there is no "building scheme" or express right to do so.
8) Clarify whether holiday homes are "dwellings" for the purposes of LTA 1985
9) Permit long lessees of flats to acquire additional rights by prescription against the common landlord
10) Amend ChI of Pt 1 of the LRHUDA 1993 so that nominee purchaser companies are entitled to levy the costs of running the freehold company from all lessees who have obtained a longer lease at a peppercorn rent.
11) Amend ChI of Pt 1 of the LRHUDA 1993 so that freeholders cannot retain the curtilage of flats after enfranchisement without good reason
12) Permit lease-backs of non-participating flats in collective enfranchisement, either by agreement with the lessees, or (perhaps with restrictions) as of right
13) Prohibit claims to enfranchise buildings containing flats as "houses" under the LRA 1967 but extend the 1967 Act rights right to cover the freehold of buildings which contain nothing other than a single dwelling (i.e. where the roof is excluded from the demise in order to abrogate 1967 Act rights). Clarify the ambit of claims to the freehold of mixed use buildings

14) Replace the entire Leasehold Reform Act 1967 with a right to acquire the freehold of leasehold dwellings which aren't "flats" or which are buildings which include only one dwelling i.e. consign to history the endlessly troublesome, hard to define "house".
15) Amend the "no Act rights" assumptions under the 1967 and 1993 Leasehold Reform Acts so as to exclude in each case rights under the other Act.
16) The amendments which might usefully be made to CLRA 2002 concerning RTM could fill a paper on their own.