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The future of home ownership: missed opportunities?

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Scott Goldstein reviews the Law Commission's trio of reports and asks whether enough has been done to facilitate the adoption of commonhold of the following preliminary observations.

On 21 July the Law Commission published three hefty reports totalling nearly 2,000 pages, loosely entitled "the future of home ownership". They address enfranchisement, commonhold, and the right to manage, and are designed to operate in conjunction with the government's wider policy objectives of making leasehold fairer, and increasing property owners' access to freehold.

A full consideration of these reports will take many months, but before starting their staycations practitioners might want to take note of the following preliminary observations.

The road less travelled

The future of home ownership began life as part of the Law Commission's *Thirteenth Programme of Law Reform*, which was laid before parliament in December 2017 in a document that makes tantalising reference to two other landlord and tenant projects close to

practitioners' hearts, which had to be abandoned (for the time being at least) due to lack of government support.

Reform of the Landlord and Tenant Act 1954

In 2017 the Law Commission estimated that the 1954 Act led to "unnecessary costs of £20-£40 million". In 2016 a number of stakeholders made submissions to the Law Commission, which included replacing the "contracting out" warning notice and tenant declaration procedure (by which statutory security of tenure is excluded) with a warning in prescribed form on the front of the lease that the tenant was giving up its 1954 Act rights; and ending the uncertainty that can arise from section 64 of the Act (concerning the commencement date of the renewal tenancy) by providing that the renewal tenancy will start either the day immediately following the expiry of the contractual term, or the day immediately following the expiry of a section 25 notice or section 26 request.

Guarantees and the Landlord and Tenant (Covenants) Act 1995

A series of cases beginning with Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330 (Ch); [2010] 1 EGLR 29 have determined (inter alia) that under the 1995 Act a guarantor of an AGA can neither continue to guarantee the AGA on assignment, nor become the assignee itself. This can cause prejudice in many commercial transactions where the parent company is the only group entity with the covenant strength to be the guarantor and the group wishes to assign the lease from one subsidiary company to another. The Property Litigation Association had proposed reforming the law to permit a guarantor to guarantee an assignor's covenant in an AGA by way of sub-guarantee; and to enable the guarantor to stand again as guarantor for the assignee, provided that certification is given that the assignment is either intragroup, between partners in the same firm, or between a firm and a company in which that firm has a controlling interest.

Enfranchisement – lowering the bar

Turning to the Law Commission's report on enfranchisement, one of the major proposed changes to the current collective enfranchisement regime is the plan to raise the percentage limit of permitted non-residential use in a qualifying building from 25% to 50%, thereby giving far more residential tenants the right of collective enfranchisement.

Increasing the threshold to 50% has a number of advantages, most obviously that (in the

words of the Law Commission) there “is a good objective argument for establishing whether a building is “residential” by simple virtue of the fact that it represents the majority”. However, this change (and the other proposals, which are intended to facilitate enfranchisement) will have wide-ranging consequences for developers, landlords and their funders. Will developers build out mixed-use developments with ever-higher proportions of commercial space to keep enfranchisement at bay? Will commercial lenders see these developments as riskier? How will these proposals be affected by the likely changes to the commercial market as a result of Covid-19? Those arguing to the contrary will no doubt say that the market adapted to the increase in the threshold of noncommercial space in enfranchisements from 10% to 25% in 2002, but it is important that these issues are aired fully.

Commonhold – has its time come?

The Law Commission is vexed by commonhold’s failure to take off, either in existing blocks or new developments. It proposes that existing blocks can convert to commonhold where there is support of eligible leaseholders of at least 50% of the flats in the building (currently there must be unanimity). Following conversion, either non-consenting leaseholders’ leases will be phased out over time (option 1); or all leaseholders will be required to take titles of commonhold units immediately, whether or not they wish to (option 2). Option 1 seems more likely, as under the Law Commission’s proposals option 2 would require the non-consenting leaseholders to be compensated by the government for the cost of acquiring their commonhold units. Even though incentives will be offered to leaseholders to “convert early”, it is inevitable that many leaseholders will choose not to do so. Thus on option 1 there would likely be a transitional period in which the residential units in the building are occupied by a mixture of commonhold unit owners (who own their unit freehold) and “traditional” leaseholders.

The commonhold and leasehold regimes provide very different protections to occupants. Although a leaseholder can challenge a landlord on the reasonableness of either estimated or incurred variable service charges, a commonhold unit holder will not have this right. Instead, the commonhold association (which owns the common parts of the building) will, subject to any dispensation agreement, need an ordinary resolution of unit holders to approve expenditure before it is incurred. Hence if option 1 were followed, the patchwork of property owners would each have different rights from each other. Letting leaseholders retain the right to withhold service charge and seek a determination from the First-tier Tribunal (Property Chamber) could increase the risk of the commonhold association

becoming insolvent, an outcome the Law Commission very much wishes to avoid.

The Law Commission decided against legislative intervention to remedy this issue for the time being, on the basis (inter alia) that many buildings, especially in the private rented sector, tend to pay a fixed rather than variable service charge, and thus do not have the benefit of the reasonableness provisions of the Landlord and Tenant Act 1985. No supporting evidence was provided for this assertion. However, the Law Commission considered that the need for additional legislation in this area be reviewed, particularly if the qualifying criteria for conversion should be relaxed in the future. With respect to the Law Commission, this is a missed opportunity because its report clearly recommends how, and why, the qualifying criteria for conversion should be relaxed. This lacuna will have to be addressed before the government enacts legislation based on the Law Commission's report.

Approval of expenditure

The directors of the commonhold association can ask unit holders to approve an ordinary resolution dispensing with the need to obtain prior approval of the association's annual expenditure. Looked at in one light, this is a means of lessening the bureaucratic burden on the unit holders. However, the unit holders do not have the protection of the landlord and tenant legislation to fall back on. Although the Law Commission's proposals allow the unit holders to pass a further ordinary resolution at any time to disapply the dispensation, there is still a risk that on the introduction of commonhold, directors (especially in large developments) persuade the unit holders to adopt the dispensation process, then use it to force through expenditure in subsequent years before any objectors are able to organise a unit holders' vote to prevent it.

Final thoughts

The Law Commission should be congratulated on its comprehensive reports, in particular the emphasis on streamlining the processes for both enfranchisement and lease extensions. However the concern must be that making it so much easier for blocks to adopt commonhold, which is an essentially untried and untested model in England and Wales, could have unintended consequences. The new proposed commonhold model is more flexible than previously prescribed but by its nature it does away with a significant element of the freedom of contract that is characteristic of leases negotiated by the parties

themselves. In the final reckoning disputes between differing factions of occupants are inevitable, and it is difficult to see why that would change with the advent with the evolution of leasehold into commonhold, despite the Law Commission's best efforts to institute safeguards. Perhaps what is needed is more guidance for all residents, whether tenants or unit holders, to help them live together in harmony.

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