

Commonhold

Necessary reforms for “Mark 2”

A paper for an all-party meeting on 11th September 2017

By Philip Rainey QC

Introduction

1. This paper is designed to follow on from a paper by James Driscoll in which James sets out the aims, achievements and difficulties of the Commonhold concept. The purpose of this present paper is to suggest concrete steps which *could* be taken to re-vitalise and re-launch a “Mark 2 Commonhold” in order to achieve the goals set when the legislation was enacted in 2002. Some are easier to adopt than others; some may appear to be more desirable or acceptable than others.
2. HOWEVER, it must now be clear that without significant change Commonhold will not succeed.

A level playing field – eliminating the comparative benefits of long leasehold

3. Clearly, it is financially advantageous for developers to grant long leases of houses and flats. A lease allows for (a) the reservation of a ground rent; (b) a reversion, which becomes more valuable as the lease term shortens and (c) the sale of the ground rent income stream and/or the reversion to investors. Commonhold allows for none of that.
4. It is thus **essential** to the successful re-launch of Commonhold that the current proposals for prohibiting new ground rents, together with a requirement that any new long leases are very long with no reversionary value, are implemented.

Tilting the playing field towards Commonhold

5. Even a level playing field may not suffice, because Commonhold remains a novelty and relatively untested. At the beginning, there will not be any evidence to suggest that a Commonhold flat will sell for a price exceeding that of a leasehold flat; indeed there will

probably be stories circulating that Commonhold flats are hard to sell which will no doubt worry both developers and buyers.

6. I have suggested before that a ready **incentive**, albeit one which costs the Government money, would be to levy a reduced rate of SDLT¹ on sales of Commonhold units. Say:
 - a more favourable SDLT rate (or even SDLT exemption) on the initial purchase of a Commonhold unit from the developer.
 - a more favourable SDLT rate (or even SDLT exemption) on the first sale/purchase of the unit after a conversion of an existing leasehold development to Commonhold.
7. Of course such incentives would have to be costed by the Treasury but that is beyond the scope of this paper, save to observe that cost would depend on take-up: if it costs a lot then it will have done its job as an incentive. The SDLT rates could be harmonised again in any Budget, once Commonhold is popular or if the “loss” to the Treasury proved to be too great.
8. Couple an incentive with the removal of the incentives to use leasehold (see above) and Commonhold might look rather attractive.

Compulsion / “sunset clause”

9. Even so, Commonhold Mark 2 may still find it difficult to gain traction among developers, buyers and mortgagees. It evidently took off in Australia because the previous system commonly used was “company title” which had particular defects beyond the long leasehold system prevalent in England & Wales therefore strata title was a clear improvement. Conditions in this jurisdiction are different.
10. Inevitably, **some degree of compulsion is required**. In my view, the adoption of Commonhold should be made compulsory. There is an argument that compulsion should be introduced in stages, by pilot schemes. As the current leasehold system shows geographical variation, and most buyers buy in their own locality, it seems logical that any

pilot of the compulsory adoption of Commonhold would be fixed geographical areas. That would also avoid any “competition” locally between commonhold and leasehold, and all local agents, conveyancers, developer regional sales teams etc. would acquire expertise.

11. It might also be prudent to limit compulsion in a pilot scheme to smaller developments in the first instance. But this is by no means essential.
12. Until bespoke provision can be agreed, some forms of development would need to be exempt from compulsion. E.g. community land trusts and retirement housing. In theory commonhold is an ideal method of operating retirement housing schemes BUT there is no way for any of the *current* funding models using event fees and so forth to work within the framework of the 2002 Act.

Conversion

13. Converting existing leasehold schemes into commonhold is, I suspect, more difficult than may first appear. Nevertheless, the current requirements for 100% agreement from all interested parties should be revoked. In particular, mortgagee consent should **not** be required.

A re-launch

14. I am on record as having previously suggested that many of the problems with Commonhold could be addressed without primary legislation. I am no longer of that view.
15. The sad position at present is that Commonhold is discredited; it is “damaged goods”. It is known to be a total failure. Many professionals in the field could not identify what is wrong with the legislation, precisely because it is a failure therefore they have never had any reason to engage with it. It follows that amending the existing legislation cannot be relied upon to restore any confidence in Commonhold because many people do not really know what the problem was in the first place so they may take some persuading that amendments are a successful fix.
16. **Therefore, my view is that the current legislation should be repealed entirely and replaced by a new Act and new Regulations.** The new Act would no doubt be very

similar to the existing Act in many respects, but sometimes the gesture in replacing a discredited piece of legislation is important.

17. I would go so far as to suggest that the name “Commonhold” itself might be jettisoned and the new Act “re-branded”, although I am unable to suggest a suitable alternative, other than to adopt “Strata Title”. There might be some merit in that, because “strata title” is known to be popular in those jurisdictions where it has been adopted.
18. It is also essential that any re-launch is heavily pushed by the Government. The advantages of commonhold to those who live in it are many, and with the current levels of dissatisfaction with leasehold, there should be a receptive audience. Publishing a “fact-sheet” is not sufficient. There is also a good deal of misunderstanding about how commonhold works; anecdotally it seems to me that some of the supposed defects are illusory once one has read through the Regulations.
19. Where public money is backing developments e.g. HCA funding, the adoption of commonhold could be a condition of the finance.

Necessary changes to the legislative regime

20. The current legislation itself (and in this I include the Commonhold Regulations 2004 which contain many of the “difficult” provisions) is defective in a number of respects. What follows is not necessarily a comprehensive list.
21. **Essential changes:**
 - (1) Permitting (with suitable safeguards against abuse) the retention of control by the developer during phased development;
 - (2) A more flexible provision for Commonhold Assessment which clearly and explicitly allows for different assessments for different areas e.g. common external areas as opposed to the fabric of buildings;
 - (3) Completely re-writing the insolvency and strike-off regime for CCAs, such that it is more clear that the default position is that a Commonhold remains within commonhold come what may and units cannot end up as unsaleable “flying freeholds”. Secured lenders have to be able to make any necessary application;
 - (4) Allowing long, shared-ownership leases within Commonhold (on suitable conditions);

- (5) Allowing a form of leasehold where required for Islamic finance;
- (6) Using banking regulation to require that all lenders operating in the regulated sector offer the same rates for commonhold units as they offer for lending charged against leases;
- (7) Giving secured lenders some rights to intervene if there is a vote to dissolve the CCA (section 43);

22. **Useful changes** which should increase faith in the system:

- (1) Re-writing the Commonhold Assessment provisions to emphasise the duty and responsibility on unit holders to pay their share of the voted budget assessment;
- (2) A straightforward method of enforcement of assessment arrears against commonhold units, including simple and effective powers of sale;
- (3) Professional Audits of expenditure; auditors to have comparable powers and status to company auditors;
- (4) A “rescue” process for failing commonholds, probably modelled on the Manager provisions in Part II of the Landlord & Tenant Act 1987. This should include some method of breaking “deadlock” where unit-holders are equally split;
- (5) A highly developed publicly accessible* register / database containing material which goes beyond the basics set out in s.5; for example, the last 6 years’ assessment accounts. (the Act probably allows for this in s.5(2) but it is necessary to know in practical terms what will be done, given the current CCA Rules which requires the CCA to maintain certain registers). *certain documents might be accessible only to unit holders and prospective purchasers.
- (6) Simplifying the dispute resolution procedures from those in the current Rules; powers to levy *finer* on rule-breakers without proving damage;
- (7) Launching an Ombudsman scheme as the Act envisages;
- (8) Other than ombudsman / ADR all other jurisdiction to be vested in the FTT not the court;
- (9) Creating a new profession of Commonhold Manager for larger commonhold schemes where it may be akin to running a large company. A professional manager should arguably be compulsory in larger commonholds;
- (10) A “bond” system for new developments, in order that defects in the build cannot simply be walked away from by the developer;

(11) Allowing for “nesting”, or “commonhold within commonhold” – in other words tiered levels of commonhold in large developments.

Detailed observations

Shared ownership

23. Social housing, in the sense of flats to be let on assured tenancies at subsidised rents, can be accommodated without change. The provider can grant such tenancies out of a Commonhold unit. But the legislation as currently drafted is unable to cope with shared ownership housing. It is difficult to disagree with the proposition that *ideally*, a bespoke solution for shared-ownership Commonhold units would be designed. A Co-ownership trust would seem an obvious vehicle. But there are enough challenges in revitalising Commonhold without embarking on the reinvention of shared ownership.
24. As an alternative, to get Commonhold moving, I suggest that a temporary “patch” could easily be designed which allows the current model of shared ownership to work in the Commonhold context.
25. I would suggest making a bespoke exception from the prohibition on the grant of a long leases of residential units, and on the grant of leases at a premium, currently found in Reg 11(1) of the Commonhold Regulations 2004. This exception would allow the housing providers to grant conventional “staircasing” shared ownership leases.
26. For shared ownership leases to work in a Commonhold context, provision would need to be made for, among other things:
 - excluding such leases from the statutory controls of service charge under ss.18-30 of the Landlord and Tenant Act 1985. This is necessary because these provisions do not apply to the commonhold assessment; the intent should be that Commonhold charges can be passed through to the lessee for payment. (Sometimes there is a contractual cap on the lessee’s contribution to service charges; such a cap can work equally well in respect of the pass-through of the Commonhold assessment).

- a trawl would have to be made of the other landlord and tenant legislation which confers rights on long residential lessees as further exclusion/modification may be necessary to remove or adapt rights which are inconsistent with Commonhold;
- rights of enfranchisement/lease extension/right-to-manage would need to be excluded where the freehold is a Commonhold;
- as a quid pro quo the shared-ownership lessee could be entitled to exercise the rights of the Commonhold unit holder to be a member of the Commonhold association and to participate in its decision making processes;
- extinguishing the shared ownership lease and transferring ownership of the Commonhold unit to the lessee once the lessee has staircased to 100% of the equity (this may well be capable of being dealt with as a matter of contract, by appropriate terms in the lease. Regulations need only require the lease to include such provision);
- Provision could usefully be made for transferring charges over the shared ownership lease onto the Commonhold unit at the point that 100% equity is achieved. Alternatively, the lease if charged could remain in place until the lessee sells and the extinguishment of the lease/release of the charge could take place at that stage.

27. The regulatory powers under ss17 and 19 of the 2002 Act are sufficiently wide that most, if not all, of the necessary provision in the commonhold regime can in my view be made by delegated legislation. Amendments would also be necessary to the statutory scheme(s) underpinning shared ownership; among other things the prescribed lease form would have to be changed.

The commonhold assessment percentage and section 38

28. In leasehold developments, particularly mixed-use or larger ones including more than one building, it is common to have more than one service charge fund with lessees having different levels of contribution to different aspects of service charge. Amending s.38(1) to clarify that the Commonhold assessment can be similarly divided with different percentages payable by the same unit is an important and necessary change.

Insolvency / winding up

29. The current provisions are seriously defective in *form* because they suggest that commonhold status may be lost if the CCA goes bust. That is not intended, and makes no sense as the result would be to devalue the assets. The insolvency provisions appear to concentrate too much on bringing the Commonhold to an end. Save in the case of redevelopment, it is difficult to see why a Commonhold development would *usefully* cease to be a Commonhold. Allowing flats to become simple flying freeholds is a disaster. Presumably it was envisaged that in case of insolvency, succession orders under s.51 would be the norm (see s.51(4)) but it is not good enough that the framework is so vague.
30. Provision could usefully be made for mortgagees to apply for such orders as may be necessary; including setting up any required successor commonhold association. S.51 does not provide for this at present. Explicit provision could also be made for mortgagees to recover from other mortgagees or unit holders the costs of “saving” the Commonhold.
31. It should also not be possible for the CCA to be struck off for non-filing of annual returns etc., or for the common property to end up escheating or going *bona vacantia*.
32. The omission of any provision for rescue of a failing Commonhold association, whether by administration or otherwise, is a real weakness which should be remedied by amendment of the 2002 Act. Deadlock is a danger where the unit holders are split on a major issue, a 2 or 4 unit commonhold would be particularly vulnerable. The ability to refer a specific decision to be taken by an independent expert or arbiter would be advantageous.
33. There have been suggestions that lenders are worried about s.43, which permits the CCA to be wound up on a 80% vote of members. Some sort of provision like this is required to allow for redevelopment, but it is arguable that lender safeguards may be required.

Rescuing the management of failing commonholds

34. It may be useful to introduce a mechanism similar to Part II of the Landlord and Tenant Act 1987 for the appointment of a statutory Manager of the Commonhold. Such a

mechanism might prevent a Commonhold association which is (for example) paralysed by dissent from lapsing into insolvency in the first place;

Dispute resolution

35. Although the Act permits jurisdiction over disputes in Commonholds to be conferred on tribunals, Reg 17 of the 2004 Regulations confers jurisdiction on the county court. The statutory power to confer jurisdiction on an approved ombudsman has not been exercised either. It would be advantageous to confer at least some jurisdiction on the First-tier Tribunal (Property Chamber).

Conversion to commonhold

36. Conversion of existing properties to Commonhold could be made easier:

- The current requirement for 100% consent of interested parties, including that of all mortgagees, is very difficult to meet in respect of existing developments. The requirement could be adapted to a majority vote, as is the case with enfranchisement and right-to-manage. The requirement for mortgagee consent could be circumscribed or removed entirely;
- An “enfranchise to Commonhold” right could be appended to the LRHUDA 1993. Conceivably, conversion to Commonhold could be made a condition of collective enfranchisement in some or all categories of case (different considerations may apply to different sizes of building or where there are commercial units or shared grounds)
- Tax rules must ensure that conversion to commonhold does not trigger SDLT or CGT liability.

Mortgages

37. Availability of mortgage finance does not now appear to be a stumbling block. But there seems to be a perception that there is a problem with lending. Banking regulations could require any lender authorised to grant mortgages over residential flats to offer a

Commonhold mortgage on conditions no more onerous than apply to an otherwise similar leasehold flat. This is essentially the position anyway, but it would send a clear message as part of any re-launch.

Conclusion

38. Can Commonhold take off? Certainly. Since strata title is widely used elsewhere, there is no reason why it cannot and will not be widely adopted here. We just have not yet alighted on the right formula.

PHILIP RAINEY QC
Tanfield Chambers,
London WC1

11 September 2017
(revised for publication)