Law Commission
Reforming the law

Leasehold home ownership: buying your freehold or extending your lease
Summary

Law Com No 392 (Summary)
21 July 2020

LEASEHOLD HOME OWNERSHIP: BUYING YOUR FREEHOLD OR EXTENDING YOUR LEASE

PART I: INTRODUCTION

1.1 On 21 July 2020, we published three reports, together with supporting documents:

(1) Leasehold home ownership: buying your freehold or extending your lease;

(2) Leasehold home ownership: exercising the right to manage; and

(3) Reinvigorating commonhold: the alternative to leasehold ownership.

The reports contain a number of recommendations that would significantly improve the position of homeowners in England and Wales. Our full reports are available at www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/.

1.2 We have produced detailed summary documents for each report, of which this is one. Those summary documents are aimed primarily at those who have an existing knowledge of the regimes covered by our reports. However, we have also produced shorter summaries that cover our three projects in one document and which are designed to be accessible to all. Those shorter summaries are also available from www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/. Our report on the enfranchisement regime is referred to as the "Report" in this summary.

1.3 Our homes are hugely important, and housing policy is high up the political agenda. There is a growing political consensus that leasehold ownership is an unsatisfactory way of owning residential property. Leasehold enfranchisement – the process by which leaseholders may buy the freehold or extend their lease – is a complex (and often inconsistent) area of law. As a result, leaseholders face unnecessary litigation, uncertainty and costs when attempting to exercise their rights under the current enfranchisement regime. This project is a root-and-branch review of enfranchisement rights. The Law Commission's recommended reforms are intended to help to make our homes our own, rather than someone else's asset. They are intended to make the law work better for leaseholders.

1.4 A project on residential leasehold and commonhold reform was included in our Thirteenth Programme of Law Reform.[1] As highlighted above, our project on enfranchisement reform is part of a wider project on residential leasehold and commonhold reform. Our Terms of Reference for all three of our projects include two general policy objectives: to promote transparency and fairness in the residential leasehold sector and to provide a better deal for leaseholders as consumers. The detailed provisions of our Terms of Reference, so far as relevant to our project on enfranchisement reform, are set out at figure 3 (paragraph 2.27) of the Report.[2]

1.5 We consulted on wide-ranging proposals to reform the enfranchisement regime between September 2018 and January 2019. As well as inviting consultation responses, we invited leaseholders to respond to a Leaseholder Survey and share

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1 Thirteenth Programme of Law Reform (2017) Law Com No 377.

2 Our full Terms of Reference are set out at Appendix 1 to the Report.

with us their experiences of the process of exercising enfranchisement rights. We also held consultation events in England and Wales and attended several events and meetings hosted by other organisations. We received more than 1,000 responses to the Consultation Paper and over 1,500 responses to the Leaseholder Survey. Following discussions with Government, we prioritised our work on the premiums that leaseholders must pay to exercise enfranchisement rights and we published our Valuation Report in January 2020.[3]

1.6 Consultees had strong views on many of our proposals – and the views of landlords and leaseholders (and their respective advisers) were sometimes opposed. When making our recommendations in the Report, we have carefully considered all consultees' comments and the reasons why they favoured or opposed a provisional proposal, and weighed the arguments made.

1.7 Alongside our three Reports, we have published a number of supporting documents. Those documents include a combined summary of our three residential leasehold and commonhold law reform projects, the responses to the Consultation Paper (which have been redacted to remove personal information and to protect those who provided their responses in confidence), a statistical summary of how consultees responded to the consultation questions, Counsel's Opinion concerning removing the requirement for leaseholders to contribute towards their landlords' non-litigation costs, together with our instructions to Counsel, and a note regarding the right to participate, which was one of the proposals in the Consultation Paper.

1.8 We make 102 recommendations in the Report. This summary provides an overview of our main recommendations in each chapter of the Report, with cross-references to the paragraphs in the Report which set out the relevant recommendations. It does not capture all the recommendations in the Report, but instead focuses on areas in which we are recommending a key change to the current law. It is designed to help readers find their way through the Report and identify areas that may be of interest to them.

PART II: WHAT SHOULD THE ENFRANCHISEMENT RIGHTS BE?

Chapter 3: The right to a lease extension

1.9 In Chapter 3, we discuss the right of leaseholders to be granted a new, longer lease of their home in place of their existing lease – a "lease extension". Leaseholders will extend their leases (rather than buy the freehold to their homes) where they do not qualify for a right of freehold acquisition, or where for some other reason they are unable to or do not wish to purchase the freehold. The right to extend a lease is particularly important for leaseholders who live in blocks of flats, where the freehold can only be obtained by leaseholders working together. In these cases, the right to a lease extension is the only enfranchisement right which a leaseholder can exercise acting alone. A lease extension offers leaseholders longer-term security in their homes, as well as a greater ability to mortgage or sell their properties.

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[3] Leasehold home ownership: buying your freehold or extending your lease – Report on options to reduce the price payable (2020) Law Com No 387. The Valuation Report is available at http://www.lawcom.gov.uk/project/leasehold-enfranchisement/.

1.10 Under the current law, leaseholders of houses and flats enjoy different lease extension rights – and it is widely agreed that the right of leaseholders of flats is more favourable. There is no reason for leaseholders' rights to diverge in this manner, and we therefore recommend a uniform right to a lease extension for all qualifying leaseholders: the right to a lease extension, at a peppercorn (in effect, zero) ground rent, as often as they so wish, on payment of a premium: paragraph 3.36.

1.11 Under the current law, the right to a lease extension enables a lease to be extended by 50 years in the case of a house and 90 years in the case of a flat. We recommend that on a lease extension claim, an additional 990 years should be added to the remaining term of the existing lease: paragraph 3.62. A lease extension of this length will place the vast majority of the home's value in the hands of the leaseholder, in line with the increasing prevalence of 999-year leases on the market, and will ensure that a lease only needs to be extended once. Our choice of 990 years rather than 999, however, reflects our recommendation in relation to redevelopment break rights for landlords. We recommend that a landlord should be entitled to obtain possession of the property, for the purposes of redevelopment, during the last 12 months of the term of the original lease or in the last five years of each period of 90 years after the commencement of the extended term: paragraph 3.62. This will ensure consistency between a landlord's redevelopment break rights in respect of leases of flats extended by 90 years under the current law and in respect of leases extended under our new regime. This is important so that landlords are able to take possession of all units within a building at the same time where it is necessary for a property to be redeveloped. A lease extension of 990 years is preferable to one of 999 years for the same reason, being a multiple of 90 years.

1.12 We proposed in the Consultation Paper that a lease extension should include all of the land let under the existing lease. We have concluded that although that approach would have worked well in most cases, it would equally have caused significant problems in others. For example, a lease of a house and a garden might also include extensive other land, such as woodland or farmland. We think that the premises that can be included in a lease extension claim must be limited to those which are in some way associated with the leaseholder's home – so that, in the example above, the lease extension should include the garden but not the other land. We have concluded that the current law does succeed in most cases in identifying the premises which should be included in a lease extension, and we therefore recommend preserving it. However, if our recommendations are taken forward, we think that it would be helpful to explore with Parliamentary Counsel whether the archaic language of the current law could be made more accessible, and whether it might be possible to adopt a more expansive approach to the requirement that premises fall within the "curtilage" of the relevant building: paragraphs 3.145 to 3.147.

1.13 We make recommendations about the terms on which a lease extension should be granted. Aside from the ground rent and the length of the lease, the starting point should be that the terms of the lease extension will be the same as those of the existing lease: paragraph 3.209. Either the leaseholder or the landlord should be permitted to require suitable variations to be made to those terms where there is a particular reason why this is necessary – for example, to take account of alterations made to the property since the grant of the existing lease, or to remedy a "defect" in the existing lease. Disputes about these kinds of variations should be referred to the

Tribunal. Our recommended scheme does not allow the parties to agree whatever terms they wish. There is often an inequality of bargaining power between landlords and leaseholders which can lead to improper pressure being applied to leaseholders, and unfavourable terms being agreed. Our recommended approach offers protection to leaseholders, whilst allowing for variations to leases to be made where that is required. We make a specific recommendation for *Aggio* lease extensions,[4] allowing the parties the freedom to agree the terms between themselves (save for the ground rent and length of the term): paragraph 3.210.

1.14 We then consider the current law regarding mortgages. Where a leaseholder obtains a lease extension for a *flat*, any mortgage over the lease automatically transfers to the new extended lease. But if a leaseholder obtains a lease extension for a *house*, a mortgage does not automatically transfer. A leaseholder has to execute "a deed of substituted security", which requires the cooperation of the mortgage lender and may delay the lease extension. We recommend that this inconsistency should be resolved; mortgages should transfer automatically in all cases: paragraph 3.240.

1.15 We recommend that the right to a lease extension should enable leaseholders to claim an extension of all appurtenant property rights benefiting the lease, regardless of whether they were granted by the landlord or a third party and regardless of whether they were granted in the lease or separately from it: paragraph 3.298 to 3.299. Appurtenant property rights are rights that a landowner has over neighbouring land belonging to another person, such as a private right of way. These rights may be essential to the leaseholder – for example, the right of way could be the only way to access his or her home – in which case it would be vitally important that the right could be extended alongside any lease extension. Our recommendations improve the position of leaseholders, since they have no right under the current law to extend appurtenant property rights granted separately from the lease.

1.16 Finally, we recommend the introduction of a new right for leaseholders who already have very long leases to buy out the ground rent under their lease without extending the term of their lease: paragraph 3.112. This was strongly supported by consultees and will be very useful to those leaseholders who are faced with a high or onerous ground rent but who have no need to extend the term of their lease. In the Valuation Report we put forward to Government the option of capping the treatment of ground rent in calculating enfranchisement premiums.[5] If Government decides not to introduce a cap, we also recommend a new right for leaseholders with "onerous" ground rents to extend the term of their lease without buying out their ground rent: paragraph 3.112. This will enable leaseholders to obtain long-term security in their homes where they might not otherwise be able to afford to do so.

Chapter 4: The right of individual freehold acquisition

1.17 In Chapter 4 we consider the right of "individual freehold acquisition". In broad terms, this gives a leaseholder who owns all the units[6] (or, perhaps, the only unit) in a building, the right to acquire his or her freehold. Primarily, the right will apply to

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4 We explain the concept of *Aggio* leases in Ch 3.

5 See the Valuation Report, at paras 6.119 to 6.154.

6 We explain the concept of a "unit" in Ch 6.

leaseholders of houses. Chapter 4 considers two main issues: first, the extent of the premises which the leaseholder will acquire, and second, the terms of the acquisition.

1.18 As in Chapter 3, we have reconsidered the provisional view in the Consultation Paper that the premises included in an individual freehold acquisition should match all the land let under the existing lease. Instead, we recommend that, as under the current law, there must continue to be some form of limit on the premises which can be included in an individual freehold acquisition claim: paragraphs 4.34, and 4.36 to 4.37.

1.19 We do, however, make a further recommendation to deal with the situation where a leaseholder qualifies for an individual freehold acquisition, but parts of the building are not included within the lease. We recommend that in such cases the leaseholder should be able to acquire the freehold of the whole building: paragraph 4.35. This recommendation provides an additional option to leaseholders of houses who have been granted internal leases – where the landlord has, for instance, retained the roof – to acquire the freehold of their house, alongside the option of a lease extension.

1.20 The remainder of Chapter 4 considers the rights and obligations that are transferred or created on an individual freehold acquisition. We examine whether existing property rights should continue to affect the freehold being acquired, whether the leaseholder should take over any personal obligations from the landlord, and whether any new property rights or personal obligations should be created.

1.21 We recommend that, as a general rule, leaseholders should acquire the freeholds to their properties subject to all existing property rights affecting the title at the time the leaseholder brings his or her claim: paragraph 4.171. For example, if the freehold has the benefit of a private right of way over a neighbour's property, it should still benefit from the right after it is acquired by the leaseholder. And if the freehold is subject to a restrictive covenant in favour of a neighbouring property that prevents the construction of additional dwellings on the site, it should still be subject to the covenant after it is acquired by the leaseholder. However, we recommend that existing property rights burdening the freehold that do not also bind the leaseholder's lease should drop away when the leaseholder acquires the freehold: paragraph 4.172. A leaseholder should not be put in a worse position as a freehold owner than they were in as a leaseholder. We also make special recommendations for mortgages, beneficial interests under trusts of land and estate contracts and options to ensure that they do not continue to affect the freehold once it is acquired by the leaseholder: paragraphs 4.172 and 4.404.

1.22 Existing personal obligations which bind the landlord should normally be of no concern to an enfranchising leaseholder as they are personal to the landlord. However, sometimes landlords are bound by a "chain" of contracts, which requires the landlord to ensure that a successor in title also enters into the relevant personal obligation. In many circumstances it might be unreasonable to pass the landlord's personal obligation on to the leaseholder – for example, where the obligation is to pay a profit-generating permission fee to an associate of the former landlord. We therefore recommend that, as a general rule, any provision of a contract which requires the landlord to ensure that the acquiring leaseholder undertakes personal obligations should be suspended by an individual freehold acquisition claim, and discharged when the claim is completed. We recognise, however, that in some cases chains of

contracts are used to ensure that positive covenants bind successive owners of land. These chains may play an important role in regulating the relationship between neighbouring landowners, and in supporting the proper functioning of housing estates. We therefore recommend an exception to our general rule designed to preserve chains of contracts which perform this function: paragraphs 4.217 to 4.218.

1.23 We make recommendations regulating the creation of new property rights during the freehold acquisition process. We recognise that the creation of new property rights can be a necessary and legitimate part of the freehold acquisition process, in order to protect the value and amenity of the leaseholder's land, and any land retained by the landlord. However, our recommendations ensure that the type of property rights that can be created are clearly defined and controlled. In particular, our recommendations help to protect leaseholders from obligations which are designed to generate a profit or provide an ongoing income stream for landlords (of a type which leaseholders often refer to as "fleecehold").

1.24 As a general rule, we recommend that a new property right should be created during the freehold acquisition process where it meets a two-stage test. Subject to some limited exceptions, it should not be possible for either landlords or leaseholders to insist on the creation of a new property right which does not meet the two-stage test. Moreover, the parties will not usually be able unilaterally to opt out of acquiring rights which meet the test: paragraph 4.337.

1.25 The first stage of the test is that any new property right must amount to an appurtenant right.[7] We make it clear that all easements amount to appurtenant rights for this purpose (reflecting the position under general property law), and so any right which can amount to an easement is capable of being created as a new property right when leaseholders acquire their freeholds. We do not replicate the narrower approach of the existing enfranchisement regime which makes provision for the creation of only limited categories of easements. We also recommend that the appurtenant rights that may be created on an individual freehold acquisition should include land obligations, introduced through implementation of our recommendations in Making Land Work.[8] This will enable both restrictive and positive covenants to amount to appurtenant rights, and, in contrast to the current law, will ensure that positive covenants are preserved where they perform an important role in protecting the value and amenity of land.

1.26 The second stage of the test under the general rule is that any new appurtenant right created during the freehold acquisition process must correspond to an existing right or obligation in the leaseholder's lease. This approach protects leaseholders, by ensuring that any new property rights simply continue arrangements already contained in their leases, and do not give the landlord (or the leaseholder) the benefit of entirely new rights. It also helps to preserve existing estate management frameworks.

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7 We explain the meaning of "appurtenant right" in para 1.15 above.

8 Making Land Work: Easements, Covenants and Profits à Prendre (2011) Law Com No 327.

1.27 As in Chapter 3, we also recommend that leaseholders should be able (but should not be required) to claim property rights which replicate rights granted by either the landlord or a third party separately from the lease: paragraph 4.351.

1.28 Finally, we recommend that it should not generally be possible to create new personal obligations during the freehold acquisition process. New personal obligations should only be created where they are contained on a list prescribed by the Secretary of State: paragraphs 4.370 to 4.371. This will protect leaseholders from the imposition of obligations which are designed to secure a purely personal benefit, rather than to protect land.

Chapter 5: The right of collective freehold acquisition

1.29 In Chapter 5, we set out our recommendations for a reformed right for multiple leaseholders to join together to purchase the freehold of their building. We call this the right of "collective freehold acquisition".

1.30 The current right of collective enfranchisement is restricted to the acquisition of a single, self-contained building or part of a building. We recommend that the new right of collective freehold acquisition should in future extend to enabling leaseholders to acquire multiple buildings or parts of buildings together: paragraph 5.102. This will allow leaseholders to own and manage several buildings together where they choose to do so – for example, blocks of flats on the same estate.[9] Leaseholders will thereby be able to exercise control over their wider environment, benefit from economies of scale and avoid the difficulties which can arise where one building forming part of an estate is taken into separate ownership and management.

1.31 We recommend that leaseholders must carry out a collective freehold acquisition claim through a nominee purchaser which is a corporate body with limited liability, such as a limited company: paragraph 5.59. This will help to address a number of problems which can arise where the freehold title is held in the names of individual leaseholders. A corporate structure provides clarity surrounding beneficial ownership, aids efficient day-to-day management of the property, and avoids the need to execute a conveyance of the freehold title to the property each time a flat is sold. However, in light of consultees' desire for flexibility, we do not recommend that leaseholders should be obliged to use a particular type of corporate body, as we had proposed in the Consultation Paper. Similarly, while we recommend the production of model constitutional documents for the most likely types of corporate body which might be used, we do not recommend that their use should be compulsory: paragraph 5.68.

1.32 We make a series of recommendations relating to the additional land which leaseholders should be entitled to acquire in addition to the freehold interest in their building: paragraphs 5.149 to 5.151.[10] As with lease extension and individual freehold acquisition claims, we recommend that leaseholders bringing a collective freehold

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9 Our recommendation gives greater flexibility than the approach we initially put forward in the Consultation Paper to enable estate-wide enfranchisement.

10 In the light of our recommendation enabling leaseholders to acquire multiple buildings or parts of buildings in one collective freehold acquisition claim, references to a "building" throughout this summary and the Report should, unless the context suggests otherwise, be taken to refer equally to a part of a building or to multiple buildings (or indeed to any combination of buildings and parts of buildings).

acquisition claim should be entitled to acquire associated premises let with the residential units in the relevant building. We also recommend that leaseholders should be entitled to acquire other land which is used exclusively by the owners and occupiers of those units. Where the owners or occupiers of the building being acquired have rights over land, but it is not used by them exclusively, we recommend that the leaseholders should be able to acquire that land either with the landlord's consent or with the approval of the Tribunal. These recommendations will enable leaseholders making a collective freehold acquisition claim to be able to acquire more of the land which they use in conjunction with their homes. We also recommend that leaseholders should be able to require landlords to take leasebacks of units within the premises being acquired which are not let to leaseholders who are participating in the claim: paragraph 5.172. This will make it cheaper for leaseholders to acquire the freehold of their building where there are flats without qualifying leaseholders, flats with non-participating leaseholders, or commercial units, and so increase the uptake of collective freehold acquisition.

1.33 We briefly discuss which rights and obligations should be transferred with the freehold, or created, on a collective freehold acquisition: paragraphs 5.173 to 5.182 We conclude that the approach set out in Chapter 4 can generally be applied to collective freehold acquisitions. We also recommend the same special rules for mortgages should apply as apply to individual freehold acquisitions: paragraph 5.195.

1.34 The final recommendation in Chapter 5 is designed to prevent claims taking place in quick succession. We recommend that after a successful collective freehold acquisition claim, the nominee purchaser should have a defence to subsequent claims for a period of two years: paragraph 5.221. This defence will enable "ping pong" claims to be resisted, and so allow new ownership and management a suitable period to bed down.

1.35 In the Consultation Paper, we also proposed the introduction of a new "right to participate" – that is, a right for leaseholders who did not participate in a collective freehold acquisition claim to purchase a share of the freehold interest held by those who did participate at a later date. We discuss this proposal at paragraphs 5.222 to 5.246. We maintain that it would be desirable in principle for leaseholders who did not participate in a collective freehold acquisition claim to be able to join in the ownership and management of the premises acquired later on. However, as we explain in the Report, we have encountered a significant number of complexities in attempting to develop this proposal, and have therefore concluded that further work would be needed before we could recommend the introduction of such a right. We explore these issues further in a separate note which is available on our website.[11]

PART III: WHO SHOULD BE ENTITLED TO EXERCISE ENFRANCHISEMENT RIGHTS?

Chapter 6: Qualifying criteria

1.36 In Chapter 6, we set out our recommendations for a new, unified scheme of qualifying criteria, which governs who is eligible for enfranchisement rights. A key aim of our recommended regime is to make more leaseholders eligible for enfranchisement

[11] The note is available at https://www.lawcom.gov.uk/project/leasehold-enfranchisement/.

rights, by liberalising several qualifying criteria and removing obstacles to enfranchisement.

1.37 Under the current law, leaseholders cannot collectively enfranchise if more than 25% of their building is used for non-residential purposes. We recommend that the percentage limit of permitted non-residential use should be raised to 50%: paragraph 6.338. This is a significant change, which will bring numerous (currently excluded) leaseholders within the collective freehold acquisition regime. Enfranchisement rights should, as a matter of principle, attach to leaseholders in buildings that can fairly be described as residential. We have concluded that a building with 50% or less non-residential use should be considered a residential building. The same justifications are applicable in the case of individual freehold acquisitions of buildings containing multiple units (such as a house that has been subdivided into flats and a shop), and we therefore recommend that the 50% non-residential limit should apply in those cases too: paragraph 6.171.

1.38 We also recommend the removal of other barriers to the exercise of one or more of the enfranchisement rights. Most significantly, we are recommending the abolition of the current two-year ownership requirement: paragraph 6.131. This will give all leaseholders the flexibility of being able to carry out an enfranchisement claim as soon as they acquire their lease, rather than having to wait for two years (while their lease term decreases and, in many cases, the premium for enfranchisement increases).

1.39 We recommend the removal of other existing obstacles to the exercise of freehold acquisition rights that are no longer properly justifiable, such as the resident landlord exclusion: paragraph 6.355. And we remove obstacles that are relatively ineffectual, only truly serving to exclude some leaseholders from rights, such as the three-or-more flats rule: paragraph 6.371. Other changes include the removal of complex, outdated criteria that can make exercising enfranchisement rights problematic and expensive for leaseholders. We recommend that the current qualifying criteria based on financial limits – both the low rent test and rateable values (which can be difficult, if not impossible, to find) – should generally be abolished: paragraph 6.115. These recommendations will make enfranchisement rights more widely available, and will remove many of the present complications for leaseholders.

1.40 Another key aim of our recommended regime is to rationalise and simplify the criteria that must be met before enfranchisement rights can be exercised. Our recommendations create a logical and unified scheme of qualifying criteria, moving away from the inconsistencies inherent in the current law. As a consequence of creating a coherent scheme, both leaseholders' and landlords' costs of seeking professional advice will be reduced, as will the number of disputes.

1.41 A fundamental element of our recommended approach is moving towards the new concept of a "residential unit", instead of distinguishing between (and creating scope for argument about) the language of "houses" and "flats": paragraph 6.45. This change will remove inconsistencies between the treatment of house and flat owners, and will provide the basis for a simple qualifying criteria regime.

1.42 We explain our recommended scheme as a series of sequential questions that should be asked in order to determine whether a leaseholder or group of leaseholders has enfranchisement rights. These questions are set out in a flowchart in our Report:

figure 6, at paragraph 6.393. The starting point is to ask the following question: "Does the leaseholder have a long lease of premises which include at least one residential unit"? This question acts as a gateway into enfranchisement rights. If the answer is "no", then the leaseholder has no enfranchisement rights. If the answer is "yes", the leaseholder has, at the very least, the right to a 990-year lease extension in respect of the residential unit. The next stage is to determine whether the right to an individual freehold acquisition arises. We set out a series of four questions which essentially determine whether the relevant building is in the ownership of a single long leaseholder. If so, the leaseholder will usually be able to acquire the freehold of that building. If not, it may be possible for a collective freehold acquisition to be carried out instead.

1.43 For a collective freehold acquisition to be available, the requirements of the current law must be met, but adapted to our new scheme: namely, there must be two or more residential units, and two-thirds of the residential units in the building must be held on long leases: paragraphs 6.264 and 6.251. As at present, the leaseholders of at least half of the residential units in the building must participate in the claim: paragraph 6.281. As we are not able to recommend the introduction of the right to participate at this time,[12] where there are only two long leaseholders in the building, both must continue to join in the claim: paragraph 6.296.

1.44 Finally, we are recommending a reformed approach to business leases, which determines whether such leases qualify for enfranchisement rights by reference to the use of the premises and the terms of the lease: paragraphs 6.67 to 6.68. This will more accurately identify the types of premises that should not qualify for enfranchisement rights (such as offices), while bringing other types of premises (such as live/work units) within the enfranchisement regime.

Chapter 7: Qualifying criteria: exceptions to the usual rules

1.45 The current law provides for a number of situations in which particular leaseholders who would otherwise qualify for enfranchisement rights in fact have more limited rights, or, in some cases, none at all. This may be because of the identity of their landlord, or the nature of the land on which their home is situated. In Chapter 7, we discuss these exceptions to the usual qualifying criteria for enfranchisement rights.

1.46 We begin by considering the operation of enfranchisement rights in relation to shared ownership leases. Our Terms of Reference require us to ensure that shared ownership leaseholders have the right to extend the lease of their home, but not the right to make an individual freehold acquisition claim or to participate in a collective freehold acquisition claim prior to having "staircased" to 100%.

1.47 We therefore make a number of recommendations to assist with the implementation of this policy decision by Government. We recommend that shared ownership leaseholders should be entitled to a lease extension of the same length as that available to all other leaseholders; but that the shared ownership nature of the lease should remain unchanged after the lease extension: paragraph 7.19. We recommend that the premium payable to extend a shared ownership lease should consist of the usual cost of buying out any ground rent payable under the lease, but only a

[12] See para 1.35 above.

proportion of the usual cost of deferring the landlord's reversionary interest in the property: paragraph 7.38. And we recommend a set of criteria which must be met if a shared ownership lease is to be excluded from freehold acquisition rights: paragraphs 7.92 to 7.93.

1.48 These recommendations will help to make the entitlements of shared ownership leaseholders much clearer for both landlords and leaseholders. Our recommendation as to the premium payable by a shared ownership leaseholder will also ensure that such leaseholders are able to obtain security in their homes at a price which fairly takes account of their unique position and the role of the shared ownership product in providing access to secure and affordable housing.

1.49 We then consider a number of further exemptions from enfranchisement claims under the existing law. Leaseholders whose landlords have the benefit of an exemption from the ordinary operation of enfranchisement rights typically feel aggrieved that they are unable to extend their leases or purchase their freehold in the same way as other leaseholders. The lack of lease extension rights in particular leaves leaseholders with a wasting asset that will, at some point, become unsaleable and unmortgageable. We make a number of recommendations designed to increase the availability of enfranchisement rights to leaseholders affected by these exemptions. In particular, we have worked with the National Trust and its leaseholders to devise a compromise position which will enable leaseholders of inalienable National Trust land (with a small number of exceptions) to enjoy the same right to a lease extension as all other leaseholders. The National Trust's unique statutory function in relation to its inalienable properties will be protected by a right for the Trust, wherever a lease has been extended, to buy back the lease at market value whenever the leaseholder seeks to dispose of it: paragraph 7.145.

1.50 We recommend the creation of one new exemption from enfranchisement claims – an exemption from freehold acquisition claims for community-led housing ("CLH") developments: paragraph 7.210. CLH is a growing sector of the housing market which enables groups of individuals to have more control over their own homes, and to run a housing development in a way which they consider to be of benefit to themselves and/or to their community. CLH is not run for profit, and developments tend to be owned and/or controlled democratically by members of the community. Since leasehold ownership is one of the primary means used to deliver CLH, an exemption from freehold acquisition claims is necessary to ensure the integrity of these developments.

PART IV: HOW SHOULD ENFRANCHISEMENT RIGHTS BE EXERCISED?

Chapter 8: Procedure – making a claim

1.51 In Chapter 8 we recommend that a new, single procedure should be adopted for all enfranchisement claims: paragraph 8.49. Parties should bring, and respond to, an enfranchisement claim by completing a single set of prescribed notices: paragraph 8.73. Our recommendations will remove the legal traps which cause claims to fail and which enable unfair procedural or tactical advantages for landlords with experience of the system.

1.52 A leaseholder who wants to know more about the ownership of a building before starting a claim can serve an Information Notice on a landlord: paragraph 8.89. If the landlord fails to respond, they could be ordered to do so by the Tribunal, or be required to cover the wasted costs of a leaseholder who chooses to commence a claim despite the lack of a response. These changes will make it easier for leaseholders to obtain the information they need to bring a claim and ensure that there are proportionate sanctions to encourage landlords to respond on time.

1.53 A leaseholder who wants to bring any type of enfranchisement claim must first complete a prescribed form of Claim Notice: paragraph 8.117. There are two routes by which a leaseholder can make an enfranchisement claim. The first route requires the leaseholder to serve the Claim Notice on the leaseholder's "competent landlord".[13] Claim Notices that are sent to prescribed categories of address (including certain email addresses) will be deemed served: paragraphs 8.242 to 8.244. We recommend that the competent landlord should be responsible for serving a copy of the Claim Notice on any intermediate landlords: paragraph 8.201. These changes will reduce delay and costs for leaseholders, and avoid a leaseholder's claim failing as a result of his or her failure to serve a copy of the Claim Notice on an intermediate landlord.

1.54 If a leaseholder serves the Claim Notice in accordance with our regime and does not receive a response from the landlord within the specified time frame, the leaseholder may apply to the Tribunal for an order determining the enfranchisement claim in the landlord's absence: paragraph 8.332. The leaseholder can therefore be confident that a landlord who does not respond to the properly addressed Claim Notice cannot later force the leaseholder to re-start the claim by arguing that the Claim Notice was not received. These changes will reduce the likelihood that costs will be wasted, either on an aborted claim, or on arguments about whether a Claim Notice had actually been received.

1.55 The second route allows the leaseholder to apply to the Tribunal for permission to proceed with the claim without serving the Claim Notice: paragraph 8.254. We recommend that before making an order for the claim to proceed, the Tribunal should be satisfied that the leaseholder could not proceed by serving a Claim Notice because the landlord could not be identified or located: paragraphs 8.333 to 8.337. This change will make it easier for leaseholders to identify the steps they should take before applying for such an order, and make it more likely that the claim can proceed even when the landlord cannot be found.

Chapter 9: Procedure – responding to a claim

1.56 In Chapter 9, we set out our recommendations for the landlord's response to a claim. In accordance with our recommendations regarding the form of Claim Notice in Chapter 8, we recommend that a Response Notice should be in a prescribed form, setting out the details of the competent landlord's response to the Claim Notice: paragraph 9.36. We also recommend that the landlord should enclose specified documents with the Response Notice, to ensure that any disputes between the parties about the terms of any transaction can be identified at an early stage: paragraph 9.37. We recommend that the validity of Claim Notices and Response Notices should only be capable of challenge in limited circumstances: paragraphs 9.63 to 9.69. This

[13] We explain the term "competent landlord" in Ch 8.

change will make it less likely that any such challenge will be made or will succeed, and will encourage parties to focus on substance rather than form.

1.57 We recommend that a competent landlord who has been served with a Claim Notice should have two months in which to complete and serve a Response Notice: paragraph 9.95. The competent landlord should not be entitled to apply to the Tribunal for more time to serve a Response Notice, but if the landlord has not served a Response Notice in time, he or she could apply to the Tribunal for permission to join the claim and to serve a Response Notice late: paragraph 9.126. If a Response Notice is served, either the leaseholder or the landlord should be able to ask the Tribunal to resolve any dispute that remains between them, including about the written terms of any lease extension or freehold transfer.

1.58 The competent landlord should be responsible for dealing with the claim, and their actions should bind all other affected landlords. But an intermediate landlord, or an owner of other land bound by property rights benefiting the lease, would be able to make representations to the Tribunal: paragraph 9.107. And an intermediate landlord could seek to take over the response to the claim from the competent landlord, either by agreement with the competent landlord or with the permission of the Tribunal: paragraphs 9.108 to 9.109. These recommendations will ensure that an intermediate landlord will be able to have conduct of a response to a claim, but only where it is appropriate for them to do so.

1.59 If a competent landlord fails to serve a Response Notice in time, the leaseholder should be able to apply to the Tribunal for a determination of the claim in the landlord's absence: paragraph 9.125. In doing so, the Tribunal should not be bound by the terms set out in the Claim Notice. This recommendation will remove the possibility of a leaseholder making a windfall gain as a result of a landlord's failure to respond, and avoid expensive satellite disputes about the service of notices.

1.60 Our recommendations for the determination of the claim in the landlord's absence are set out in Chapter 8.[14] A competent landlord should only be able to set aside a determination that has been properly obtained on limited grounds: paragraph 9.151. This will save costs by discouraging landlords from delaying their involvement in an enfranchisement claim in the hope of overturning any determination made in their absence.

1.61 Finally, we recommend that a leaseholder's claim should not be treated as withdrawn simply because he or she has failed to apply to the Tribunal for a determination of the claim. But if no such application is made within six months of the service of a Response Notice, a landlord (or certain other leaseholders) should be able to ask the Tribunal to strike out the Claim Notice, provided that the leaseholder has been given 14 days' notice of the proposed application: paragraph 9.177. We also make recommendations as to the limited circumstances in which the Claim Notice should be deemed to be withdrawn. These changes will reduce the likelihood that an enfranchisement claim will be treated as withdrawn simply because a procedural deadline has been missed, while allowing stale claims to be struck out.

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[14] See paras 1.54 and 1.55 above.

Chapter 10: Completing a claim

1.62 Having set out our recommended procedure for how leaseholders can make enfranchisement claims and how landlords can respond to them, we consider in Chapter 10 some issues that may arise as claims are progressed towards completion.

1.63 We recommend that the service of a Claim Notice should no longer create a statutory contract as it does under the current law: paragraph 10.27. Rather, the parties' general obligations are set out in our new scheme but the parties are given freedom to decide how they wish to go about progressing the claim (and whether they want to use a contract at all). They should be able to apply to the Tribunal as a "one-stop shop" for resolving any disputes.

1.64 The current law about the effect of Claim Notices creates two traps for leaseholders. First, if a leaseholder serves a Claim Notice and then wishes to sell the lease with the benefit of that notice, the benefit needs to be expressly assigned at the same time as the transfer of the lease. If it is not assigned, the claim is deemed withdrawn. The new owner will need to bring a fresh claim and the former leaseholder may have to pay the landlord's costs relating to the withdrawn claim. Second, a Claim Notice needs to be protected, either by registering a notice against the landlord's registered title or by registering a land charge in the case of unregistered land. If the notice is not protected (or not protected quickly enough) and the landlord sells the freehold, the new landlord will not be bound by the claim. The leaseholder will need to start again.

1.65 To resolve these problems, we recommend that the benefit of a Claim Notice should automatically be transferred with the affected lease, unless the transferring leaseholder expressly withholds the transfer of the benefit: paragraph 10.54. But to avoid purchasers of leases being unexpectedly burdened with unwanted or flawed claims, we also recommend that purchasers should be able to disclaim the transfer of the benefit of the Claim Notice. We also recommend that a Claim Notice should not have to be registered in order to bind a new landlord who acquires the freehold: paragraph 10.81.

1.66 We recommend that landlords should be obliged to inform their mortgage lenders of a lease extension not less than 21 days before completion: paragraph 10.106. Leaseholders should be obliged to send a copy of the new lease to their lenders not more than one month after completion: paragraph 10.122. It is desirable for mortgage lenders to be informed of lease extensions because we have made separate recommendations in Chapters 3, 4 and 5 for lease extensions to be deemed to be authorised by the landlord's mortgage lender and for mortgages over the existing lease automatically to transfer to the new lease.

1.67 Finally, we address two problems which may arise when enfranchisement claims come to be completed. First, we recommend that leaseholders should be able to elect to merge their leasehold and freehold titles on completion of a freehold acquisition claim. Third-party property rights benefiting or burdening the lease should then automatically transfer to the freehold: paragraphs 10.147 to 10.149. Second, we consider cases in which a landlord is unable to transfer the freehold to the leaseholder or grant a lease extension because a third party has rights affecting the freehold. We recommend that mortgagees and beneficiaries under trusts of land should be deemed to consent to the transfer of the freehold or the grant of a lease extension. And we

recommend that the service of a Claim Notice should suspend the operation of any agreements between the landlord and a third party which prevent the relevant transfer or grant. Subject to some exceptions, the same rule should apply to agreements which oblige the landlord to require the leaseholder to take on new obligations in order for the transfer or grant to take place: paragraphs 10.210 to 10.212.

Chapter 11: Dispute resolution

1.68 Many of our recommendations will reduce the frequency with which disputes will arise during enfranchisement claims. Where disputes do arise, the jurisdiction to deal with those disputes is currently divided between the county court and the Tribunal. In Chapter 11, we recommend ending the current separation of responsibility for dealing with disputes. In future, all disputes should be heard and resolved by the Tribunal, which includes expert valuers as members and so has particular skill and expertise in relation to enfranchisement disputes: see paragraph 11.29. This change will make it easier for parties to identify the steps they need to take to resolve a dispute, and – in combination with our recommendations in respect of litigation costs in Chapter 12, which provide for parties generally to bear their own costs in a Tribunal claim – will allow parties to be clearer from the start about the likely costs of bringing an enfranchisement claim.

1.69 We also make recommendations in respect of the power of the Tribunal to enforce a determination that it has already made or to enforce any agreement reached between the parties. We recommend that where a party has failed to execute a lease extension or transfer, the Tribunal should have power to execute that document in place of the party in default: paragraph 11.30. We also recommend that, where a party has failed to tender the premium required for a lease extension or transfer, the Tribunal should have the power to order either that any determination made should be set aside and the Claim Notice struck out, or that any contract between the parties should be discharged unless the premium is paid by a specified date. And we recommend that the Tribunal should have access to the Court Funds Office to take receipt of funds where necessary, without the delay and cost of involving the county court: paragraph 11.31.

1.70 We also recommend that certain valuation-only disputes should be dealt with by a single valuer member of the Tribunal rather than at a full hearing: see paragraph 11.49 to 11.51. We have not made a recommendation as to the scope of this "alternative track" as we think the Tribunal is best placed to decide which types of dispute would be suitable based on the value of the claim, the difference between the parties' positions, and the proportionality of there being a full hearing of the claim. These recommendations will save both time and costs by ensuring that, in suitable cases, the parties will not be required to embark upon a full hearing.

Chapter 12: Costs

1.71 Under the current law, leaseholders are required to pay for certain "non-litigation costs" incurred by their landlords when responding to an enfranchisement claim. In Chapter 12, we recommend the elimination or control of the leaseholder's liability for those costs, depending on the valuation methodology adopted by Government following consideration of our options for reform of the price payable on enfranchisement as set out in the Valuation Report: paragraph 12.56. In either case,

our recommendations will ensure that leaseholders will be clearer as to the non-litigation costs involved in bringing a claim from the outset.

1.72 We recommend that if Government adopts a valuation methodology that is broadly market-value based, leaseholders should not generally be required to make any contribution to their landlord's non-litigation costs on successful completion of the claim. A price agreed on the open market reflects the fact that the parties are expected to pay their own costs, and we conclude that there are only limited situations where the landlord should receive compensation in respect of those costs beyond that which is reflected in the price. In low value claims (where the premium payable is below a prescribed sum), we recommend that the leaseholder should be required to contribute to the landlord's reasonably incurred non-litigation costs, but that the total amount paid by the leaseholder to the landlord (including any premium) will not exceed that prescribed sum. We also recommend that a fixed sum should be payable by the leaseholder where the landlord has incurred additional costs as the result of an election made by the leaseholder that has the effect of reducing the price payable (for example, requiring the landlord to take a leaseback of part of the building).

1.73 If Government does not adopt a valuation methodology that is broadly market-value based, we recommend that leaseholders should continue to contribute to their landlord's non-litigation costs. However, we also recommend that any such contribution should be calculated in accordance with a fixed costs regime: paragraphs 12.109 to 12.111. A fixed costs regime removes the need for a process of assessing costs, saving the parties both time and money, and prevents landlords from using their non-litigation costs as leverage in negotiations on the price of the lease extension or freehold. We also recommend the introduction of a system of security for costs: paragraphs 12.145 to 12.146. This system will provide assurance to landlords that the money that they are entitled to recover from leaseholders as part of the claim will be paid, and ensures that the approach to security for costs (unlike the requirement to pay a deposit under the current law) is consistent across the different enfranchisement rights.

1.74 We also make recommendations that will reduce the financial impact of repeated failed claims. Landlords who have faced a prescribed number of unmeritorious claims made by the same leaseholder (whether individually or with others) in respect of the same premises should be able to apply to the Tribunal for an Enfranchisement Restraint Order against that leaseholder: paragraphs 12.165 to 12.167. Any leaseholder who has been made subject to such an order would need to obtain the permission of the Tribunal before he or she could bring a further enfranchisement claim.

1.75 We also consider the liability for each party to pay the other's litigation costs. Our recommendation that all enfranchisement disputes should be heard by the Tribunal means that litigation will take place within a "no costs-shifting" environment, with the starting point being that the parties bear their own costs. We recommend that the Tribunal's existing limited powers to order one party to pay the litigation costs of another party should – subject to a few specified exceptions – apply in relation to all enfranchisement disputes: paragraphs 12.187 to 12.188. The Tribunal should therefore normally be able to order one party to pay the other party's litigation costs only where one party is guilty of unreasonable conduct: paragraph 12.196. This

recommendation will prevent leaseholders being pressured by landlords to abandon or settle their claim on less favourable terms to avoid the risk of being ordered to pay the landlord's litigation costs.

1.76 Finally, in order to ensure that our costs regime cannot be circumvented by the terms of the leaseholder's lease, we recommend that any term of a lease or collateral agreement that purports to allow a landlord to recover litigation or non-litigation costs arising out of an enfranchisement claim should be unenforceable: paragraph 12.204.

PART V: INTERMEDIATE LEASES AND OTHER LEASEHOLD INTERESTS

Chapter 13: Intermediate leases and other leasehold interests

1.77 Chapter 13 focuses on the treatment of intermediate leases and other leasehold interests in an enfranchisement claim.

1.78 We recommend that any settlement reached between a leaseholder and the landlord who is dealing with a claim, and any determination of that claim by the Tribunal, should be binding on all other landlords: paragraph 13.45. To provide protection for these other landlords, we recommend that the landlord dealing with the claim should owe a duty to other landlords to act in good faith and with reasonable skill and care, and that other landlords should be able to apply for directions from the Tribunal about the conduct of the response to the claim. In return, we recommend that a landlord who is not dealing with the claim should be required to provide all information and assistance as the landlord dealing with the claim reasonably requires, and to contribute to the non-litigation costs of the landlord dealing with the claim.

1.79 We make a number of recommendations in respect of the treatment of intermediate leases in enfranchisement claims. In the case of collective freehold acquisition claims, we recommend that the nominee purchaser should have power to elect whether to acquire an intermediate lease as part of an enfranchisement claim: paragraph 13.51. We also apply this general rule to intermediate leases that were created as part of a previous acquisition: paragraph 13.60. This would allow the leaseholders bringing the claim to elect not to buy out intermediate interests with a high reversionary value, or not to acquire intermediate leases of certain units and require the former landlord to take a leaseback of those units in accordance with our recommendations in Chapter 5.

1.80 We also make recommendations in relation to specific forms of intermediate lease where the intermediate leaseholder is eligible to participate in a collective freehold acquisition claim. Where an intermediate lease of a residential unit is held by a leaseholder who also holds a sub-lease of that unit, the leaseholder should choose whether their interest is acquired: paragraphs 13.67 to 13.69. We also recommend introducing the option to sever *Aggio* head leases: paragraph 13.82. This flexibility ensures that leaseholders who are entitled to participate in the claim do not necessarily lose their intermediate lease in the process, and ensures that leaseholders bringing the claim do not have to acquire (and pay for) the whole of that lease.

1.81 In addition, we discuss other forms of leasehold interest which may be acquired as part of a collective freehold acquisition claim. Under the current law, a lease that

contains common parts as well as other property (such as a residential unit) can be acquired in its entirety by the enfranchising leaseholders. This power can cause injustice to a leaseholder whose lease also includes common parts. We recommend that the Tribunal should have power to order the relevant lease to be acquired by the nominee purchaser, or severed in order to separate the common parts (which would then be acquired by the leaseholders): paragraphs 13.104 to 13.105. As a result, the risk that a leaseholder who holds a lease which includes common parts will have their entire lease acquired as part of a collective freehold acquisition claim will be reduced.

1.82 Other leases of common parts may be granted to third parties for development purposes. These leases may, under the current law, be acquired as leases of common parts. We recommend that nominee purchasers should be able to elect whether to acquire development leases, or acquire only the part of that lease which contains common parts: paragraphs 13.106 to 13.107. This allows leaseholders to choose whether to acquire (and pay for) the development value within these leases, or acquire only the common parts and preserve the intended development. These recommendations also reduce the incentive for landlords to grant such leases as a means of deterring enfranchisement claims.

1.83 The current law limits the enfranchisement rights of leaseholders whose landlord holds a lease that has itself been extended. We recommend that this restriction is removed in all cases (whether the lease was extended under the current law or our recommended regime): paragraph 13.117. This allows leaseholders who would not otherwise have been able to extend their lease to obtain a more valuable long-term interest in their homes.

1.84 Our Terms of Reference require us to examine options to reduce the level of the premium paid on enfranchisement. We therefore do not make a recommendation about the approach to calculating enfranchisement premiums where there are intermediate leases, but instead set out an option that Government could pursue. In determining the premium payable on enfranchisement, we suggest that the existence of any intermediate lease could generally be disregarded: paragraph 13.145. This option would simplify the calculation of the premium and create greater fairness between leaseholders, as premiums would not differ solely because of the existence or otherwise of one or more intermediate leases. This approach also has the potential to create greater fairness between landlords. In the same vein, we recommend that on any individual lease extension claim, the rent payable by an intermediate landlord should be commuted on a pro rata basis: paragraph 13.158.

PART VI: VOLUNTARY TRANSACTIONS AND CONTRACTING-OUT

Chapter 14: Voluntary transactions and contracting out

1.85 In Chapter 14 we consider the regulation of voluntary transactions – or, in the language of our Report, transactions that are “not on statutory terms”. The ability of parties to enter into transactions that are inconsistent with our new statutory regime could undermine that regime and creates a risk that some leaseholders could be persuaded to enter into such transactions on unreasonable terms. For example, a leaseholder might be tempted by a proposed deal which appeared to be cheaper than a claim under the statutory scheme, but which contained onerous future liabilities. The regulation of such transactions is outside our Terms of Reference. We recommend,

however, that Government should consider regulating both lease extensions and individual transfers (that is, the transfer of the freehold to a leaseholder rather than a group of leaseholders) that are not on statutory terms: paragraph 14.122. We do not make the same recommendation in respect of collective transfers that are not on statutory terms as we think that such transactions have clearer benefits and carry fewer risks for leaseholders than either lease extensions or individual transfers that are not on statutory terms, particularly as it is inherently more difficult for a landlord to take advantage of a group of leaseholders.

1.86 Having recommended that Government consider regulating lease extensions and individual transfers that are not on statutory terms, we consider the form that such regulation might take. We suggest that any lease extension or individual transfer that is not on statutory terms should remain valid and registrable at HM Land Registry. However, we suggest that the relevant lease extension or transfer must be approved in advance by the Tribunal as being objectively reasonable and fairly priced. If Tribunal approval is not obtained, we think there should be consequences as to the effect of the relevant transfer or lease. First, any lease extension that is granted for a term or at a ground rent that is not consistent with our statutory scheme should be treated as having been granted on terms that were consistent with our statutory scheme. Second, where a lease extension or individual transfer contains certain obligations that are inconsistent with our statutory scheme, those obligations should be unenforceable at the election of the leaseholder. Finally, a lease extension may omit certain terms or an individual acquisition may not include the grant of rights that, in each case, should have been included under our statutory scheme. Under these circumstances, we suggest that the landlord must ensure that such terms are added into the new lease or ensure the grant of the relevant rights, as relevant. If the landlord does not or cannot remedy the relevant omission, we suggest that he or she should be liable for any losses suffered by the leaseholder as a result. These suggestions seek to prevent leaseholders from being persuaded to agree to lease extensions or transfers that have been drafted on unreasonable terms.

1.87 Finally, we consider the existing power of the parties to enter into a lease extension that excludes or restricts the ability of the leaseholder to exercise their statutory enfranchisement rights in the future. We conclude that including any such right within our new enfranchisement regime would be an unjustified interference with the ability of leaseholders to transform their leasehold interest to freehold, or to extend their lease in order to place the vast majority of the home's value in the hands of the leaseholder. We therefore recommend that any agreement – whether a lease extension, the grant of a new lease or any other form of agreement – that purports to exclude or restrict the ability of a leaseholder to exercise the enfranchisement rights contained in our recommended regime should be void: paragraph 14.134.