

Commonhold – It Is Broke, But Let’s Not Fix It

Leasehold Reform Is a Better Solution to Tenants’ Problems

Commonhold, introduced in 2002 as new way to hold land and intended to deal with a number of problems associated with the leasehold ownership of flats in particular, has been one of the greatest flops imaginable. The Law Commission is seeking evidence on how it might be made to work, noting that fewer than 20 commonholds have been created since the law came into force on 27 September 2004. It would be better to make some simple, but radical, changes to landlord and tenant law instead.

Why Was Commonhold Invented?

Commonhold was intended to fix some substantial problems with the established way in which flats are sold to owner-occupiers. English property law has historically been averse to landowners being bound by obligations created by previous owners. Some obligations created between landowners are enforceable against future owners, but only ones that are directly related to the land, and which benefit other land in near proximity – for example, obligations not to use land other than for residential purposes. However, positive obligations, such as to make payments to keep a building in repair, are not directly enforceable against successors to freehold land. This makes freehold ownership of flats very difficult, as each flat owner needs to be able to rely on their fellow flat owners contributing to common costs.

Problems for Leaseholders

As leases can contain enforceable positive obligations, the way round this was the use of long leases to give flat owners as close an approximation to freehold ownership as could be achieved whilst allowing for the enforcement of vital positive obligations. In practice, this means that almost all owner-occupied flats in England and Wales are held on leases that were originally granted for terms of between 99 and 999 years. This gave rise to three problems in particular:

- **Leases expire** – Leases must, as a fundamental legal differentiation from freeholds, be granted for a period of time only and not be indefinite. Sooner or later, all tenants face the expiry of their lease and with it the right to stay in their home – meaning that leasehold properties are wasting assets, losing value the nearer they come to the end of the agreed term.



- **Conflicts of interest** – The split in ownership between leaseholders and a freeholder means that unscrupulous landlords could manage a block for their own profit rather than in the interests of the tenants who live there and who together own almost all the value in the block. This causes regular problems in relation to service charges.
- **Costly rents** – Leases will all require tenants to pay a rent, and whilst many long residential leases provide for nominal rents, others require tenants to pay substantial annual sums for properties that they might reasonably think they own outright, or risk eviction.

Commonhold as a Solution

Commonhold attempts to deal with all of these problems by providing for the freehold ownership of flats and corporate ownership of common parts, where the company is owned and controlled by owners of the flats. It is very similar to the laws of condominium and strata title, which are widespread and highly successful in the US, Canada and Australia. The flat owners are bound by standard term obligations in relation to the common parts, including to contribute fixed proportions of the costs of their maintenance. To anyone who knows the residential market, this will seem very familiar – because these issues have been substantially addressed already.

Existing Solutions to Leaseholders' Problems

The first two of the problems mentioned above (leases being wasting assets and the costs of common services) have been the subject of a series of reforming Acts of Parliament. Rights to extend leases in return for statutorily determined payments to landlords have helped to mitigate the first problem, whilst the introduction of statutory rights to buy freeholds and for tenants to take over the management of their blocks from absentee landlords has helped with the second. Only the third problem, the cost of substantial ground rents, remains unaffected by legislation.

The result of this is that leasehold ownership of flats, whilst by no means ideal, works well enough. Mortgagees will lend on leasehold flats and in a market with a chronic shortfall of supply, there will always be buyers, so developers can sell them. Even if commonhold were a perfect replacement for the current system, developers have no incentive to introduce it – commonhold will not get them higher prices or more saleable assets. Indeed, trying to sell flats under the unfamiliar commonhold over the tried and (more or less) trusted leasehold might slow sales down. Current commonhold rules are also unhelpfully rigid in relation to sharing costs, so that, for example, ground-floor tenants have to pay towards the cost of lifts they never use.

Compulsory Commonhold?

Tenants would be forgiven for letting out a hollow sigh at any suggestion that the current legislation has protected them adequately. The briefest of online searches reveals owner-occupier tenants with substantial and long-running disputes with their landlords, often over the costs of extending leases or unreasonably high management charges. So, if developers have no incentive to change to commonhold, is there a case to force the change in the interests of occupiers?

Whilst the argument for reform is strong, the real question is whether further leasehold reform would be better than forcing developers to use commonhold in new schemes. Two of the problems identified above could be addressed fairly simply:

- **Perpetual leases** – The problem of lease expiry and the consequent cost of the extension of leases is in large part due to the rule that leases may not contain rights of renewal in perpetuity – at present, a lease that contains such a right is deemed (due to the operation of the Law of Property Act 1922) to be a lease for a term of 2,000 years. The result is that whilst a tenant may be granted a very long lease, there is no mechanism for that lease to be extended indefinitely. A simple repeal of the deeming rule affecting perpetual renewal of long leases of residential properties would deal with this without adversely affecting the interests of landlords, as long as the provision for perpetual renewal has been made unambiguously in each lease.

- **Ground rent cap** – The problem of excessive ground rents can be addressed by a limit on the level of rent that can be charged or collected. Whilst rent control has a chequered history and often has unintended consequences in the short-term tenancy market, there should be very limited impact in capping ground rents at, for example, £100 per year at 2018 prices. Whilst there is a genuine and legitimate market for ground rents (they are, for example, a very good investment for long-term income funds, such as annuity providers), this market could run very well on rents below this level, as most of them already are.

Conclusion

Landlord and tenant law has some flaws in relation to the ownership of residential property, but it is not fundamentally broken. Commonhold, whilst a well-intentioned attempt to fix those flaws, has no compelling benefits for developers and enough flaws in its current format to put off lenders and buyers. Taking two simple, if radical, steps to change landlord and tenant law would be a better way to protect residential leaseholders than the currently floated reform of commonhold.

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