SQUIRE PATTON BOGGS

Mixed-Use Mayhem: UK Landlords Don't Make Too Many Plans for Your Common Parts

Mixed-use development is a useful strategy for addressing the challenges of the modern market. The reducing need for office and retail space is balanced by the ongoing demand for residential and industrial offerings. Mixed-use can still be a traditional retail and residential mix or, just as commonly now, a far more diverse offering from which we see residential or office use combined with leisure or retail or both. The challenges of online shopping, an "everything now" culture and a shifting market combine to create the perfect environment for successful mixed-use development.

However, mixed-use landlords of developments with a residential aspect should remain mindful of the extensive rights that their residential tenants enjoy – rights that affect ownership, management and sale of the property.

A recent appeal against a First Tier Tribunal decision highlights the reach of such rights and how critical it is that landlords:

- Correctly identify the extent of relevant areas within a property in planning a development and in subsequent dealings
- Carefully consider the definition of "common parts" for the purpose of future planning, as L.M. Homes Ltd [1] discovered when a nominee purchaser for the tenants successfully acquired the leasehold interests to the "common parts" of the building, including basement, subsoil and airspace – areas which landlords may well consider theirs

The building in question in *L.M. Homes* was purpose-built residential, not mixed-use. However, there are important messages to be taken from the judgment around what constituted "common parts" that landlords of mixed-use buildings will want to be alive to.

Tenants' Rights – Why Should Mixed-use Landlords Care?

Residential tenants, including those living within mixed-use developments, have significant statutory rights. Subject to qualifying criteria, these include:

- **A right of first refusal** when the landlord makes a "relevant disposal" (a definition that includes the sale of the freehold and, arguably, the grant of a commercial lease) where the internal floor area of the residential part of the property is at least 50% of the whole (excluding common parts).
- **A right collectively to purchase the freehold of the building** (a collective enfranchisement claim). This potentially includes commercial areas where the internal floor area of the non-residential parts is no more than 25% – again, not taking account of the common parts. Critically, the tenants have the right to acquire the common parts where they are needed for the proper management or maintenance of those common parts. It was this right that the tenants in *L.M. Homes* were seeking to enforce.
- **A right to take over the management of the building** where no more than 25% of the internal floor area of the building is used for non-residential purposes. Under the relevant legislation, if this right is exercised, it will only apply to the residential parts. However, critically, it can include plant that also services the non-residential parts of the building.

Planning and operating a mixed-use development without a thorough understanding of these rights can come back to bite when least expected, not least because it is clear from the qualifying criteria that the extent of the common parts and what they are used for is critical in both determining whether the rights come into play and how extensively.

What Is a Common Part?

Common parts include "the structure and exterior of the building or part and any common facilities within it". Case law governs how that definition is applied.

In *L.M. Homes*, the First Tier Tribunal had decided that the nominee purchaser was entitled to acquire leases of areas which the Tribunal held to be common parts of the property.

1 L.M. Homes Ltd & Others v Queen Court Freehold Company Ltd [2018] UKUT 367 (LC)

The owners of the leases of the common parts appealed to the Upper Tribunal, but, to their consternation, the nominee company walked away with not only the freehold (which was not disputed), but also the leasehold interests relating to:

- The roof area and air space above it
- Two-thirds of the built basement and the staircase serving it (the total basement area comprising about one third of the footprint of the building)
- The subsoil at basement level under the remainder of the building

The lease owners had paid significant sums for these leases and had plans to redevelop the common parts in question to provide additional residential accommodation. The risk that the residential tenants might acquire those interests apparently had not been considered.

Common Parts at Risk

What constitutes "common parts" is well-rehearsed at law and is generally understood to be those parts of the building that may be used by or for the benefit of the residents as a collective whole (as opposed to those parts of the building that are for the exclusive benefit of none, one or only a few residents). Such areas might include light wells, flats used for caretaker occupation, shared recreational areas, common amenities and lifts.

The legislation granting these rights (along with clarifying case law) has been around for some time, so it is interesting to consider why L.M. Homes Ltd might have fallen foul of it.

The basement – It is not difficult to see how the Upper Tribunal accepted the arguments around the basement being a "common part", housing as it did boiler equipment and service installations. With no feasible alternative offered, the unsurprising conclusion was that acquisition of the basement was necessary for effective management and maintenance.

The subsoil – That the subsoil was held to be a "common part" has been dubbed "surprising". The tenants had no obvious interest in the subsoil. The party with the benefit of the lease of the subsoil could carry out the intended development without harming the structure of the building itself. Notwithstanding those points, the Upper Tribunal found that the residents might at some point need to "manage the subsoil", so its acquisition was necessary for its proper maintenance and management. The Tribunal's reasoning was that the subsoil offered a "shared use and benefit" insofar as it bore the weight of the foundations upon which the building rests.

The airspace – Similarly, the airspace above the building was a "common part". It was part of the exterior of the building and the residents would need access to service common facilities.

Whilst the need for access to the basement was self-evident, a requirement for access to the subsoil and airspace was less clear-cut. It is, perhaps, not surprising that the lease owners were caught out here.

Why Is the Case Important?

Definitive statements have emerged around what may be considered part of the building and the status of airspace, basement and other areas as common parts – areas that landlords may well have considered theirs where there was no obvious shared use or amenity.

Landlords with development plans will need to plan well ahead to ensure that how the relevant areas are utilised will not prejudice those plans further down the line. Whilst there are statutory mechanisms for determination of price where a tenant is entitled to acquire a superior interest, the owner of that interest may well consider that it is not fully compensated for actual loss in the long term, particularly where development plans exist.

Care should also be taken when dealing with properties to ensure that "relevant disposals" for the purposes of the legislation are correctly identified and, when on the receiving end of an enfranchisement claim, landlords may well have to be prepared to give up more than they bargained for.

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